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INTERNATIONAL FINANCE FALL 2006: Packet V.

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DEFAULT INTEREST PROVISION

For a case stating that a 1% default interest provision did not constitute a penalty because it was a modest increase and reflected the increased risk for the lenders after a default by a borrower see **Lordsvale Finance plc v Bank of Zambia** [1996] 3 All ER 156 (QBD, Colman J.)[1]:

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[1] Compare, e.g., *Norwest Bank Minn., N.A. v. Blair Rd. Assocs., L.P.*, 252 F. Supp. 2d 86 (District of New Jersey 2003) (rejecting argument that a default interest provision was a penalty: “Where enforceable, a stipulated damages clause is referred to as liquidated damages... Nevertheless such a clause requires judicial scrutiny because it may constitute an oppressive penalty and hence be unenforceable...a default interest rate, like late fees, is subject to the test of reasonableness.”); cf.

... Where, however, the loan agreement provides that the rate of interest will only increase prospectively from the time of default in payment, a rather different picture emerges. The additional amount payable is ex hypothesi directly proportional to the period of time during which the default in payment continues. Moreover, the borrower in default is not the same credit risk as the prospective borrower with whom the loan agreement was first negotiated. Merely for the pre-existing rate of interest to continue to accrue on the outstanding amount of the debt would not reflect the fact that the borrower no longer has a clean record. Given that money is more expensive for a less good credit risk than for a good credit risk, there would in principle seem to be no reason to deduce that a small rateable increase in interest charged prospectively upon default would have the dominant purpose of deterring default. That is not because there is in any real sense a genuine pre-estimate of loss, but because there is a good commercial reason for deducing that deterrence of breach is not the dominant contractual purpose of the term.
It is perfectly true that for upwards of a century the courts have been at pains to define penalties by means of distinguishing them from liquidated damages clauses. The question that has always had to be addressed is, therefore, whether the alleged penalty clause can pass master as a genuine pre-estimate of loss. That is because the payment of liquidated damages is the most prevalent purpose for which an additional payment on breach might be required under a contract.
However, the jurisdiction in relation to penalty clauses is concerned not primarily with the enforcement of inoffensive liquidated damages clauses, but rather with protection against the effect of penalty clauses. There would therefore seem to be no reason in principle why a contractual provision, the effect of which was to increase the consideration payable under an executory contract upon the happening of a default, should be struck down as a penalty if the increase could in the circumstances be explained as commercially justifiable, provided always that its dominant purpose was not to deter the other party from breach.

In **Murray v Leisureplay plc** (2005)[2] the English Court of Appeal had to consider the question whether a contractual provision for damages in an employment contract functioned as a penalty. Lady Justice Arden said:

29 The penalty issue is one of considerable jurisprudential interest. English law is well-known for the respect which it gives to the sanctity of contact. The question which the law of penalties poses is this: to what extent does English contract law allow parties to a contract to specify for

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Cantamar, L.L.C. v. Champagne, 2006 UT App 321 ("We conclude the 30% per annum default interest rate agreed to by DSI under the terms of the Note is not substantively unconscionable. In light of DSI's execution of prior notes with previous lending companies, DSI was not an inexperienced party to such agreements... and cannot claim surprise, particularly where the default interest rate under the Note was lower than the interest rates of the two prior notes the Note refinanced. Additionally, because the Note constituted a refinancing of DSI's prior obligations under two earlier promissory notes to a different lender, including unpaid interest and fees, Cantamar assumed more than a minimal amount of risk in refinancing DSI's earlier loans. Even presuming the Note's default was "high by some standards," the Utah Supreme Court has previously explained that "[a]cquisition of high risk capital almost always requires the payment of a premium," and thus "[i]t is not sound legal policy to establish rules so strict as to unnecessarily dampen legitimate and desirable business activity.")

[2] [2005] EWCA Civ 963 at http://www.bailii.org/ew/cases/EWCA/Civ/2005/963.html

their own remedies in damages in the event of breach? The answer is that English law does not in this particular field take the same laissez-faire approach that it takes to (for example) the question whether parties can agree to time limits for the performance of obligations which they subsequently find difficulty in meeting. So far as that is concerned, pacta sunt servanda. So far as pre-determined damages clauses are concerned, English contract law recognises that, if the parties agree that a party in breach of contract shall pay an unjustifiable amount in the event of a breach of contract, their agreement is to that extent unenforceable . The reasons for this exception may be pragmatic rather [than] principled....

43 The usual way of expressing the conclusion that a contractual provision does not impose a penalty is by stating that the provision for the payment of money in the event of breach was a genuine pre-estimate by the parties to the agreement of the damage the innocent party would suffer in the event of breach. As Lord Dunedin said in the Dunlop case, the "essence" of a liquidated damages clause is "a genuine covenanted pre-estimate of damage" ... As the Dunlop case and the citation from the Philips case... show, a contractual provision does not become a penalty simply because the clause in question results in overpayment in particular circumstances. The parties are allowed a generous margin..

54 With the benefit of the citation of authority given above, in my judgment, the following (with the explanation given below) constitutes a practical step by step guide as to the questions which the court should ask in a case like this:-

i) To what breaches of contract does the contractual damages provision apply?

ii) What amount is payable on breach under that clause in the parties' agreement?

iii) What amount would be payable if a claim for damages for breach of contract was brought under common law?

iv) What were the parties' reasons for agreeing for the relevant clause?

v) Has the party who seeks to establish that the clause is a penalty shown that the amount payable under the clause was imposed in terrorem, or that it does not constitute a genuine pre-estimate of loss for the purposes of the Dunlop case, and, if he has shown the latter, is there some other reason which justifies the discrepancy between i) and ii) above?

55 A point that neither the Dunlop case nor the Cine case considers is the position if either there is no evidence at trial as to why the parties agreed a particular clause, or if the evidence is that they did consider it but took a wholly wrong view about what damages would be payable under the general law in the event of breach. In the Dunlop case, trial had taken place and there had been evidence as to why Dunlop needed the clause. In the Cine case, trial had not take place but the court proceeded on the basis that there would or could be evidence about the reasons for the clause in question at the trial to which the case was remitted. What happens if there is no evidence about the reasons for the clause? There would in my judgment be no reason why the court could not draw inferences of fact as to the reasons and as to the genuineness of those reasons. What if it appears from the evidence that is given (or from the inferences that the court makes from the facts) that the decision to include the damages clause was included on the basis of a mistaken belief that the damages at common law would be assessed on a materially more generous basis than in fact would occur? This would be the case if for example the parties failed to have regard to the fact that a party would have to give credit for a benefit that he obtained on breach, such as a tax saving as a result of the receipt of damages for lost income in the form of a lump sum payment of damages. In my judgment, the good faith belief of the parties is not the deciding factor here. The court would look at the result and (bearing in mind that the onus is on the party challenging the clause to establish that it is a penalty) ask whether it is satisfied that the parties could not, if they had had the proper information or considerations in front of them, genuinely have considered that the damages

payable under the contractual provision were a realistic pre-estimate of the damages payable on breach at common law. In other words, in the context of Lord Dunedin's speech, the test of genuineness is objective. A pre-estimate is genuine if it is not unreasonable in all the circumstances of the case.

The other two judges in the case took what they described as a broader view in which they approved of the approach of Colman J. in the Lordsvale Finance case and also suggested that courts should be more reticent about invalidating contractual provisions than Lady Arden's judgment suggested. For example, Lord Justice Buxton said:

116 It is therefore necessary to stand back and look at the reality of this agreement. Although I agree that evidence about it is sparse, I am prepared to take judicial notice of the fact that an entrepreneurial company such as MFC, promoting a product conceived by one man, will often place a high value upon retaining the services, and the loyalty and attention, of that one man as its chief executive: to the extent of including in his "package" generous reassurance against the eventuality of dismissal. That such reassurance exceeds the likely amount of contractual damages on dismissal does not render the terms penal unless the party seeking to avoid the terms can demonstrate that they meet the test of extravagance posited by Lord Dunedin and by Lord Woolf. I regard that as a comparatively broad and simple question, that will not normally call for detailed analysis of the contractual background. Applying that test, which I accept differs from that adopted by my Lady, I would accordingly allow the appeal on the penalty issue.
117 I would add this. The difficulty that the court has in identifying a penalty in an orthodox commercial contract is demonstrated by the outcome of the Dunlop case itself. The clause in question was a standard form, imposed on all of Dunlop's customers, that required the payment of five pounds by way of "liquidated damages" if the customer did any one of the acts of tampering with marks on the goods; selling at under list price; supplying to persons blacklisted by Dunlop; or exporting without Dunlop's consent. Contrary to what would be thought today, the House did not view the fact that the clause was part of a contract of adhesion as undermining its status as an agreement freely bargained for... The clause imposed a single payment for any of a varied series of breaches; but assisted by Dunlop's evidence as to the benefits to the company of the price maintenance policy (expressly so described) that the clause imposed, as set out in particular by Lord Atkinson in both the Dunlop cases, the House concluded that an explanation of the clause in commercial rather than deterrent terms was available. That commercial explanation lay in Dunlop's desire enforce its commercial policy without the difficulty and burden of proving the quantum of damage accruing from every particular breach of that policy.
118 Dunlop differed from the present case in that the House was impressed by the difficulty of proving an exact loss in every, or any, of the many cases of breach to which the clause extended. That particular problem does not affect our case. But the cautious approach of the House, and its willingness to look at the clause in its commercial context, does at least underline the importance stressed by Lord Woolf of not moving automatically from the fact that a clause could result in greater recovery than the amount of the actual loss to an assumption that without further justification the clause must be penal in nature.

RELATIONSHIPS BETWEEN LENDERS AND THE ARRANGER AND AGENT BANKS

Look at the provisions in the loan agreement which govern the relations between the different participants.[3] Would you be happy with these provisions if you were: the arranger; the agent; a lender; or the borrower? The interests of the different parties may conflict.

Does the Arranger/ Agent bank/ a lender owe fiduciary duties to the borrower?

A bank which obtains confidential information about a firm may be precluded from using that information for its own benefit. In **United Pan-Europe Communications NV v Deutsche Bank AG**[4] UPC complained that DB had used confidential information it had acquired as a participant in syndicated loans to UPC in formulating a bid to acquire another firm (in competition with UPC). The following brief excerpt is from Lord Justice Morritt's judgment in the Court of Appeals :

37. The fiduciary duty is alleged to have arisen from the key banking relationship formerly existing between UPC and DB, the mutual trust and confidence without which it could not properly operate and the requirement duly performed that UPC pass to DB confidential information of the type referred to on a regular basis. The amended points of claim also allege a contractual duty and a duty to the like effect to be implied from established banking practice in both England and Germany. Before us no reliance was placed on the contractual duty as it would not give rise to the proprietary remedy sought. We have not seen any evidence of banking practice. Accordingly the existence of the duty alleged must arise, if at all, from the three factors to which I have already referred.
38. Both parties agreed that the relevant law was to be found in the judgment of Millett LJ in Bristol and West Building Society v Mothew [1996] 4 All ER 698 at 711-712... (approved by the Privy Council in Arklow Investments Ltd v Maclean [2000] 1 WLR 594 at 599):
'A fiduciary is someone who has undertaken to act for or on behalf of another in a particular matter in circumstances which give rise to a relationship of trust and confidence. The distinguishing obligation of a fiduciary is the obligation of loyalty. The principal is entitled to the single-minded loyalty of his fiduciary. This core liability has several facets. A fiduciary must act in good faith; he must not make a profit out of his trust; he must not place himself in a position where his duty and his interest may conflict; he may not act for his own benefit or the benefit of a third person without the informed consent of his principal. This is not intended to be an exhaustive list, but it is sufficient to indicate the nature of fiduciary obligations. They are the defining characteristics of the fiduciary. As Dr Finn pointed out in his classic work Fiduciary Obligations (1977) p.2, he is not subject to fiduciary obligations because he is a fiduciary; it is because he is subject to them that he is a fiduciary.'
39. In this respect Jacob J considered (para 17) that:

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[3] If you want to read further on this issue you could look at Gavin R. Skene, *Arranger Fees in Syndicated Loans - A Duty to Account to Participant Banks?*, 24 PENN ST. INT'L L. REV. 59 (2005).

[4] [2000] 2 BCLC 461

'In Arklow Investments Ltd v Maclean [2000] 1 WLR 594, because the defendants had not undertaken the job, it was held that they had never become fiduciaries. [Counsel for UPC] submitted that the facts of this case were otherwise because DB had undertaken tasks for UPC. Thus the law did make them fiduciaries. As I have said I am not convinced that the present evidence would justify such a conclusion in relation to anything to do with TeleColumbus. No doubt DB would be fiduciaries in relation to the matters undertaken. What is really at stake here is the width of those fiduciary obligations and, in particular, whether they extend well beyond those tasks. As I say that will involve a fuller investigation of those tasks and of banking practice."
40. In this passage the judge recognises, and I agree, that DB was under some fiduciary duty to UPC the scope of which could only be determined at the trial. A similar problem arose in New Zealand Netherlands Society 'Oranje' Inc v Kuys [1973] 2 All ER 1222 ...The question was whether the conduct complained of came within the scope of the defendant's fiduciary duty as an officer of the society... Lord Wilberforce noted that a person in the position of Kuys might be in a fiduciary position quoad a part of his activities and not quoad other parts, 'each transaction, or group of transactions, must be looked at'. He approved as a principle of general application the statement of Dixon J in Birtchnell v Equity Trustees, Executors and Agency Co Ltd (1929) 42 CLR 384 at 408 that:
'The subject matter over which the fiduciary obligations extend is determined by the character of the venture or undertaking for which the partnership exists, and this is to be ascertained, not merely from the express agreement of the parties . . . but also from the course of dealing actually pursued by the firm.'
41. As I understood him counsel for DB did not disagree. He accepted that, for example, having lent money to UPC for the acquisition by UPC of Telekabel NV, DB was precluded from then bidding for Telekabel NV in competition with UPC. Thus the issue is not the existence of the fiduciary duty but of its scope. That issue is one that is largely dependent on the facts and cannot be resolved at this stage. Accordingly in my view the court must approach this application on the footing that there is a seriously arguable case for breach of fiduciary duty as well as misuse of confidential information.

In a recent decision in New York, **EBC I Inc v Goldman Sachs** [5] the New York Court of Appeals found that claims that Goldman Sachs had breached fiduciary duties as an underwriter of a securities offering survived a motion to dismiss:

Goldman Sachs argues that the relationship between an issuer and underwriter is an arms-length commercial relation from which fiduciary duties may not arise. It may well be true that the underwriting contract, in which Goldman Sachs agreed to buy shares and resell them, did not in itself create any fiduciary duty. However, a cause of action for breach of fiduciary duty may survive, for pleading purposes, where the complaining party sets forth allegations that, apart from the terms of the contract, the underwriter and issuer created a relationship of higher trust than would arise from the underwriting agreement alone.
Here, the complaint alleges an advisory relationshipthat was independent of the underwriting agreement. Specifically, plaintiff alleges eToys was induced to and did repose confidence in Goldman Sachs's knowledge and expertise to advise it as to a fair IPO price and engage in

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[5] http://www.lsta.org/assets/files/Home_Page/News/etoys%20decision.pdf or http://www.courts.state.ny.us/reporter/3dseries/2005/2005_04478.htm

honest dealings with eToy's best interest in mind. Essentially, according to the complaint, eToys hired Goldman Sachs to give it advice for the benefit of the company, and Goldman Sachs thereby had a fiduciary obligation to disclose any conflict of interest concerning the pricing of the IPO. Goldman Sachs breached this duty by allegedly concealing from eToys its divided loyalty arising from its profit-sharing arrangements with clients.
Contrary to Goldman Sachs's contention, recognition of a fiduciary duty to this limited extent -- requiring disclosure of Goldman Sachs's compensation arrangements with its customers - - is not in conflict with an underwriter's general duty to investors under the Securities Act of 1933 to exercise due diligence in the preparation of a registration statement... An obligation not to conceal from the issuer private arrangements made with a group of potential investors does not compromise Goldman Sachs's charge to be truthful in its public disclosure regarding the issuer's business. For similar reasons, we do not share the dissent's concern that upholding an issuer's fiduciary duty claim against an underwriter "potentially conflicts with a highly complex regulatory framework designed to safeguard investors" ... Recognizing a common law remedy, under these circumstances, will not hinder the efforts being expended to regulate in this area.... Goldman Sachs warns that to find a fiduciary relationship in this case may have a significant impact on the underwriting industry. We think its concern is overstated. To the extent that underwriters function, among other things, as expert advisors to their clients on market conditions, a fiduciary duty may exist. We stress, however, that the fiduciary duty we recognize is limited to the underwriter's role as advisor. We do not suggest that underwriters are fiduciaries when they are engaged in activities other than rendering expert advice. When they do render such advice, the requirement to disclose to the issuers any material conflicts of interest that render the advice suspect should not burden them unduly.
Accepting the complaint's allegations as true, as the Court must at this stage, plaintiff has sufficiently stated a claim for breach of fiduciary duty. This holding is not at odds with the general rule that fiduciary obligations do not exist between commercial parties operating at arms' length -- even sophisticated counseled parties -- and we intend no damage to that principle. Under the complaint here, however, the parties are alleged to have created their own relationship of higher trust beyond that which arises from the underwriting agreement alone, which required Goldman Sachs to deal honestly with eToys and disclose its conflict of interest -- the alleged profitsharing arrangement with prospective investors in the IPO.

Judge Read, dissenting, said:

This new fiduciary obligation wars against our precedent and potentially conflicts with a highly complex regulatory framework designed to safeguard investors...we have..until today.. refrained from injecting fiduciary obligations into sophisticated, counseled parties' arm's length commercial dealings. In refusing to fashion a "newly-notched fiduciary-like duty" for finders in Northeast Gen. Corp. v Wellington Adv. (82 NY2d 158, 161 [1993]), we remarked that "[i]f the parties find themselves or place themselves in the milieu of the 'workaday' mundane marketplace, and if they do not create their own relationship of higher trust, courts should not ordinarily transport them to the higher realm of relationship and fashion the stricter duty for them."...In allowing plaintiff's claim for breach of fiduciary duty to go forward, the majority disregards that eToys was a sophisticated, well-counseled business entity... Further, the offering price was a key term in the underwriting agreement, a purchase contract between eToys, the issuer/seller, and Goldman, the underwriter/buyer, who represented all the underwriters in the syndicate. How may a buyer ever owe a duty of the highest trust and confidence to a seller regarding a negotiated purchase price? The interests of a buyer and

seller are inevitably not the same. Indeed, it is a longstanding principle of contract law that a buyer may make a binding contract to buy something that it knows its seller undervalues... Here, eToys' prospectus acknowledged that the "initial public offering price for the common stock has been negotiated among eToys and the representatives of the underwriters" (emphasis added). Contrary to plaintiff's allegation, eToys also represented in the prospectus that the offering price was not driven by anticipated demand alone. The other factors that came into play were "eToys' historical performance, estimates of eToys' business potential and earnings prospects, an assessment of eToys' management and the consideration of the above factors in relation to market valuation of companies in related businesses." Further, eToys' prospectus identified four "principal purposes" for the IPO: to increase working capital, create a public market for its stock, facilitate future access to the public capital markets, and increase visibility in the retail marketplace. By selling only 8.2% of its outstanding common stock at $20 a share, eToys raised the capital called for by its business plan.
In short, the offering price was not "set" by Goldman, it was negotiated by sophisticated, represented parties—the issuer/seller and the underwriter/buyer; the offering price was negotiated with reference to more than "then current market conditions" and "anticipated demand"; and eToys did not seek to negotiate an offering price solely to maximize the proceeds raised in the offering. Documentary evidence in the record confirms all these points, and the nature of the contractual relationship between an issuer and an underwriter is long-established and well-understood...
How our new fiduciary duty for underwriters may fit into or conflict with the developing regulatory scheme is impossible to predict. We have, however, at the very least introduced uncertainty into a complex subject of enormous importance to investors. This subject is, in my view, better dealt with by specialized regulators than by the evolving common law..

The Loan Syndications and Trading Association (LSTA) expressed concern about this decision[6]:

This opinion is of potential concern to the loan market for a number of reasons. For the first time, the highest New York court has, as the dissent argued, injected "fiduciary obligations into sophisticated, counseled parties' arms-length commercial dealings." Although this decision applied to a securities underwriting, it was based on New York common law, not federal or state securities statutes, and therefore could potentially apply equally to the relationship between borrowers and underwriters of large corporate loans. It is particularly relevant because New York law is frequently chosen as the governing law for large syndicated corporate loans.
In light of the Court of Appeal's decision, underwriters of syndicated corporate loans may seek to protect themselves against a borrower's claim of breach of fiduciary duty by expressly disclaiming any fiduciary duties as advisor or otherwise. These disclaimers should be included at the outset in engagement and commitment letters that govern the parties' relationships, and should make clear that the underwriter will not assume any fiduciary duties.

In a decision published this summer, *HF Management Services LLC v. Pistone,* [7] the New York Appellate Division emphasised that the Court of Appeals in the Goldman

[6] http://www.lsta.org/story.asp?catid=0&id=1635

[7] http://www.courts.state.ny.us/REPORTER/3dseries/2006/2006_05153.htm

Sachs case had said that the underwriter/issuer relationship is not usually a fiduciary relationship:

In the case at bar, nothing in the record even remotely suggests that the relationship between Morgan Stanley and WellCare rose above the typical contractual relationship of an underwriting agreement between a buyer and a seller. Both parties were separately counseled. In fact, the underwriting agreement specifically identified EBG as the "special regulatory counsel for the underwriters" and acknowledged that another law firm was serving as outside counsel for WellCare. Certainly, there is no indication or suggestion that Morgan and WellCare enjoyed any type of pre-existing relationship, or that Morgan acted as an "expert advisor on market conditions" to WellCare in the same way that Goldman Sachs apparently advised eToys..

Does the Arranger/ Agent bank owe fiduciary or other duties to the lenders?

The loan agreement will seek to limit obligations of the arranger in different ways. One set of limitations focuses on the obligation of the lenders to make their own credit assessments. In general courts are likely to uphold these provisions. In **Bank of the West v Valley National Bank of Arizona**, 41 F.3d 471 (1994) a case arising out of a loan participation the 9th Circuit said this:

...Valley National acted as though the relationship was that of a lead bank doing all the investigation and exercising all the judgment, and the participating bank passively investing in the lead bank's lending program. Valley National's problem is that regardless of what they actually did, the banks expressly agreed to a relationship in which each would investigate independently and exercise independent judgment. There was no lack of clarity in the contract, no mutual mistake, no reason to suppose that the parties mutually intended any relationship other than what the contract said. The loan participation agreement expressly provided that the Bank of the West "does not assume and shall have no responsibility or liability" for Technical Equities' financial condition, the collateral, or collectibility of the loan. Valley National agreed that it "independently and without reliance upon any representations of Lender . . . made and relied upon [its] own credit analysis and judgment." Valley National promised to "continue to make and rely upon" its own decisions "independently and without reliance upon" Bank of the West.

Those are plain and strong words. The most favorable characterization of Valley National's conduct which the evidence allows is that it promised not to rely on Bank of the West, but then did in fact rely on Bank of the West. That necessarily implies that, to the extent that it did rely on Bank of the West, Valley National's reliance was not justifiable.

The contract could as a practical matter only control litigation outcomes, not conduct. Valley National might choose to advance millions of dollars without making an independent credit evaluation, in reliance on Bank of the West's judgment, even though it promised not to do that. That might be a rational business judgment, if experience with Bank of the West had always been very good, Technical Equities looked good, and an independent evaluation would cost more money than the value of the risk which it would likely avert. But the contract could and did control whether such reliance would be "justifiable" for purposes of a fraud claim...

Other provisions limit the liability of an agent bank in relation to various aspects of the loan relationship:

Chemical Bank v Security Pacific National Bank[8]
That Security Pacific owed a fiduciary duty to the plaintiffs is established by the credit agreement of April 8, 1983 which unequivocally identifies Security Pacific as the agent bank. The very meaning of being an agent is assuming fiduciary duties to one's principal. Restatement (Second) of Agency § 1(1). The holding of this court in First Citizens Federal Savings and Loan Association v. Worthen Bank and Trust Co., 919 F.2d 510 (9th Cir. 1990), which requires "unequivocal contractual language" to create a fiduciary duty, is not to the contrary. In that case the bank was the principal lender and was identified as "an independent contractor." Id. at 512, 514. There was no intention on the part of this court to abandon "the special concern common law courts have traditionally and consistently exhibited to supervise and enforce fiduciary relationships," including the fiduciary relationship when one bank acts as the agent for another bank. Women's Federal Savings and Loan Association v. Nevada National Bank, 811 F.2d 1255, 1258 (9th Cir. 1987).
Impressed with a fiduciary responsibility, Security Pacific failed to carry it out. Beyond question, it breached its duty and its contract. Beyond question it acted negligently. But there is no law against parties to a contract relieving themselves of liability by contract, particularly when they are sophisticated institutions represented by knowledgeable counsel. The credit agreement that all three banks signed went a long ways toward relieving Security Pacific of what it might otherwise have been expected to do. It was explicitly not required to "be responsible in any manner" for the "enforceability" of the credit agreement. According to the credit agreement, it was liable only for its "own gross negligence or willful misconduct."....
It is, no doubt, odd that three sophisticated lending institutions would enter into an agreement with themselves that puts the responsibility on their agent in such a doubtful state that lay persons, chosen more or less at random, are to be the ones to determine whether the responsibility was met. But if these banks chose to operate their business in this way, it is not the court's function to provide a judge to determine a question that properly belongs to a trier of fact.

The context seems to be significant. Courts are likely to be less willing to decide that fiduciary duties arise in the context of arm's length commercial transactions between sophisticated parties than in other cases. Do you think that this is the right approach?

Gavin Skene, an Australian lawyer, writes in a recent article[9]:

The complex relationships formed between the arranger, the borrower and the participant banks under a syndicated loan exposes the arranger to considerable legal risk. The nature of the role assumed by the arranger under these relationships is often competing and adverse to the interests of each other party, including the arranger's own self interests, under the syndicated loan.
This position is especially true where an arranger has also been appointed as agent bank under a syndicated loan because its duties and obligations will "shift" primarily from the borrower and possibly the participant banks to just the participant banks when one role ceases and the other

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[8] 20 F.3d 375 (9th Cir 1994)

[9] See note 3 above.

commences. Accordingly, there may be circumstances where it is unclear as to whom the arranger owes certain duties, the length of time that the duties are owed, or whether such duties have merged....

Modern courts of common law jurisdictions have wrangled generally with the expansion of the law of equity into the province of commerce. The inherent incompatibility between equity, which promotes fairness and justice on the one hand, and commerce, which protects self-advancement and self-promotion on the other, can be clearly illustrated in the case of the invocation by a court of a fiduciary relationship between an arranger and the participant banks under a syndicated loan.

It is generally accepted that the relationship between an arranger and a participant bank falls outside the boundaries of the established fiduciary relationship categories. Therefore, an Australian court must have regard to the relevant jurisprudence relating to the intrusion of the fiduciary relationship into commercial transactions when considering whether or not the character of the relationship between an arranger and participant bank is one that exhibits the necessary characteristics present in a fiduciary relationship.

Given the size and volume of syndicated loans made in the global marketplace each year, it is surprising that there is little authoritative case law in common law jurisdictions that examines the set of legal relationships between the actors of a syndicated loan generally and the legal rights and obligations that flow between an arranger and the participant banks specifically....

...arrangers of syndicated loans should be mindful that if it is determined that the benefit to any arranger fees was enjoyed by an arranger in its capacity as agent bank and not as arranger of a syndicated loan, there is a risk that the said arranger will owe equitable duties to account to the participant banks for the receipt of such arranger fees procured in its capacity as agent for the participant banks.

In **Sumitomo Bank Ltd v Banque Bruxelles Lambert SA** [1997] 1 Lloyd's Rep 487 (QBD, Langley J.), the court found that the fact that BBL owed limited duties as agent under the loan agreement did not prevent a wider duty of care from arising out of the relationship between the parties. In this case the loans were to finance the purchase of commercial property, and there were mortgage indemnity guaranty policies (MIGs) underwritten by Eagle Star which would protect the banks against losses if the borrower defaulted on the loans. After default Eagle Star argued that the MIGs were void for non-disclosure. The banks argued that BBL as arranger of the loans had a duty to ensure that the borrower performed its disclosure obligations under the MIGs. BBL argued that the terms of the loan agreement were inconsistent with the duty of care, implied terms and fiduciary duties that the banks were arguing for. BBL also argued that there was a clear market practice that unless there was a specific written warranty or assurance an arranging bank did not owe duties to participating banks. Consider the following excerpt from the judgment:

(2) Duty of care

Two basic approaches to the question whether in a given case a duty of care arises can be discerned from the leading authorities. The first can be summarized in the familiar rubric of foreseeability, proximity, and whether the imposition of a duty of care would be fair, just and reasonable. The second can be summarized in the words "voluntary assumption of responsibility". In this case, I do not think it matters which approach is taken as in my judgment the result is the same on either basis but I will set out what I think to be the major statements of

principle supporting the two approaches.

First, Caparo Industries Plc v Dickman, [1990] 2 AC 605. I need not state the facts. The principles are to be found in the speeches of Lord Bridge at pp 620-621 and Lord Oliver at p 638.

Lord Bridge said:

> The salient feature of all these cases (cases where a duty of care had been held to arise) is that the defendant giving advice or information was fully aware of the nature of the transaction which the plaintiff had in contemplation, knew that the advice or information would be communicated to him directly or indirectly and knew that it was very likely that the plaintiff would rely on that advice or information in deciding whether or not to engage in the transaction in contemplation. In these circumstances the defendant could clearly be expected, subject always to any disclaimer of responsibility, specifically to anticipate that the plaintiff would rely on the advice or information given by the defendant for the very purpose for which he did in the event rely on it. So also the plaintiff, subject again to the effect of any disclaimer, would in that situation reasonably suppose that he was entitled to rely on that advice or information communicated to him for the very purpose for which he required it. The situation is entirely different where a statement is put into more or less general circulation and may foreseeably be relied on by strangers to the maker of the statement for any one of a variety of different purposes which the maker of the statement has no specific reason to anticipate.

Lord Oliver said:

> What can be deduced from the Hedley Byrne case, therefore, is that the necessary relationship between the maker of a statement or giver of advice ("the adviser") and the recipient who acts upon it ("the advisee") may typically by held to exist where (1) the advice is required for a purpose, whether particularly specified or generally described, which is made known, either actually or inferentially, to the adviser at the time when the advice is given; (2) the adviser knows, either actually or inferentially, that his advice will be communicated to the advisee, either specifically or as a member of an ascertainable class, in order that it should be used by the advisee for that purpose; (3) it is known either actually or inferentially, that the advice so communicated is likely to be acted upon by the advisee for that purpose without independent enquiry, and (4) it is so acted upon by the advisee to his detriment.

Second, the approach in Henderson v Merrett Syndicates Ltd, [1994] 2 Lloyd's Rep 468; [1995] 2 AC 145 namely, whether it can be said that the defendant voluntarily assumed or undertook responsibility to the plaintiff in respect of the subject-matter of the representation. After an analysis of the speeches in Hedley Byrne, Lord Goff at pp 488-489; pp 180-181 said:

From these statements, and from their application in Hedley Byrne, we can derive some understanding of the breadth of the principle underlying the case. We can see that it rests upon a relationship between the parties, which may be general or specific to the particular transaction, and which may or may not be contractual in nature. All of their Lordships spoke in terms of one party having assumed or undertaken responsibility towards the other . . . Again though Hedley Byrne was concerned with the provision of information and advice, the example given by Lord Devlin of the relationship between solicitor and client, and his and Lord Morris's statement of principle, show that the principle extends beyond the provision of information and advice to include the performance of other services. It follows, of course, that although, in the

case of the provision of information and advice, reliance upon it by the other party will be necessary to establish a cause of action (because otherwise the negligence will have no causative effect), nevertheless there may be other circumstances in which there will be the necessary reliance to give rise to the application of the principle. In particular, as cases concerned with solicitors and client demonstrate, where the plaintiff entrusts the defendant with the conduct of his affairs, in general or in particular, he may be held to have relied on the defendant to exercise due skill and care in such conduct.

. . . Furthermore, especially in a context concerned with a liability which may arise under a contract or in a situation "equivalent to contract", it must be expected that an objective test will be applied when asking the question whether, in a particular case, responsibility should be held to have been assumed by the defendant to the plaintiff: See Caparo per Lord Oliver.

Lord Goff also addressed the relevance of the contractual context to the principles he had stated. He held that in principle the existence of concurrent remedies in contract and tort was established in law and that (at p 498, col 1; p 194):

. . . an assumption of responsibility coupled with the concomitant reliance may give rise to a tortious duty of care irrespective of whether there is a contractual relationship between the parties, and in consequence unless his contract precludes him from doing so, the plaintiff who has available to him concurrent remedies in contract and tort may choose that remedy which appears to him to be the most advantageous.

Those words must, in my judgment, apply a fortiori to circumstances where the relevant relationship and assumption of responsibility arises (if it arises) before the contract comes into existence and the relevant duty in tort should in practical terms have been performed at the time the contract was concluded. That was the position as regards the obligation of disclosure in this case and, moreover, as I have held, the relevant contract, namely the loan agreement, was not addressing that obligation nor inconsistent with it.

That this is so is further illustrated by the unreported decision of the Court of Appeal in Holt v Payne Skillington and De Groot Collis, Dec 18,1995. That decision demonstrates that a duty of care can be owed in tort which is more extensive than the express or implied obligations to be derived from the terms of the contract made between the same parties. Lord Justice Hirst in giving the judgment of the Court said (at p 15), after referring to the passage from the speech of Lord Goff in Henderson v Merrett to which I have referred:

. . . as Lord Goff made clear . . . it will frequently be the case that the relevant assumption of responsibility does occur within a contractual context. That fact does not mean that it must necessarily do so simply because, at some stage during the relevant course of dealing between the parties, they choose to and do enter into some form of contract. A consideration of the individual facts and circumstances of each case will determine whether any duty of care in tort which the general law may impose is of wider scope than any contract to which the same parties may agree at some stage during the same course of dealing. It is important to emphasise that the duty of care in tort is, in appropriate circumstances, imposed by the general law, whereas the contractual obligations result from the common intentions of the parties. In our opinion, there is no reason in principle why a Hedley Byrne type duty of care cannot arise in an overall set of circumstances where, by reference to certain limited aspects of those circumstances, the same parties enter into a contractual relationship involving more limited obligations than those imposed by the duty of care in tort. In such circumstances, the duty of care in tort and the duties imposed by the contract will be concurrent but not coextensive. The difference in scope between the two will reflect the more limited factual basis which gave rise to the contract and the absence of any term in that contract which precludes or restricts the wider duty of care in tort.

Those words, in my judgment, apply here where the loan agreement established and looked forward to the role of BBL as agent bank but did not relate to or look back to their role as arranging bank prior to the agreement.

BBL was putting together the transactions and had an interest in getting the banks to participate in them and indeed was being rewarded for that role. Mr Fraser himself readily acknowledged that the MIGs were for each of the banks a key part of the transaction and that he knew at the time that if BBL did not comply with the disclosure obligation in the policies Eagle Star could avoid the policies which would have the consequence for each of the banks that they would be unable to enforce them. MrFraser agreed that it would also have been obvious to the banks that that was so. While asserting his belief that the duty of disclosure rested on each of the banks he said he thought each of the banks, including BBL, had a duty of care "on one another" in effect to avoid that consequence. He agreed that the banks could not know or verify whether BBL had complied with the disclosure obligation and that each of the banks in each transaction relied on BBL to perform that obligation and he knew at the time that they did so. In addition it was his view, as it was the view of the banks, that the disclosure obligation was not an exceptional or onerous one and of course not only had it been negotiated by BBL but it was no greater than the "obligation" BBL in effect owed to itself in its own interests to establish the efficacy of the policy. The fact that Mr Fraser or BBL may have believed that the arrangements were "non-recourse" is in these circumstances of no materiality. That was not communicated to the banks and the test of duty is objective.

On the other side, the banks had to rely on BBL performing the disclosure obligation as it was (as I have held) tailored to BBL's own procedures. Each bank expected and relied on BBL to perform the obligation and believed it would and indeed, and understandably, hardly contemplated that it would not do so. That expectation and reliance was in my judgment entirely reasonable.

In these circumstances I think the relationship between BBL and the plaintiff banks was, to use the words of Lord Goff in Henderson v Merrett, a "classic example" of a relationship where a duty of care did arise on BBL to the banks as regards the performance of the disclosure obligations under the MIGs.

There was an assumption of responsibility by BBL to the banks to perform that duty. BBL was "the arranger" of the facility. It assumed as such the obligation to negotiate and agree the MIGs with Eagle Star. It did so on terms whereby, as I have held, it and it alone was the insured under the policy and it and it alone had and could perform the disclosure obligation provided for in it which depended on its own expert procedures and its skill and judgment in deciding what should be disclosed to Eagle Star. BBL knew the validity of the policies depended on its proper performance of that obligation. It knew the policies were vital to the interests both of itself and the banks and that the banks were dependent upon it for the performance of the disclosure obligation which effectively was entrusted to it in all their interests. The banks relied on BBL accordingly as BBL knew they would. Loss to the banks if the duty was not performed was foreseeable and indeed foreseen by BBL. The duty arose in the context of the specific purpose of the loan transactions. Nor, for the reasons I have given, do I think the existence of a duty of care does any violence to or is in any way inconsistent with any market practice or the provisions of the loan agreements.

For these reasons in my judgment, and whether one approaches the matter by way of Caparo or Henderson v Merrett, the answer is the same. BBL owed the plaintiff banks a duty of care in carrying out the disclosure obligation under the policies in relation to both the Cornlease and Bridgecirc transactions.

Is the judge in Sumitomo v BBL generally just unfriendly to the idea of a limitation of liability, or do you think that BBL could have effectively protected itself against liability in this case? Why did it not do so?

Can a minority bank force the majority to take particular action under the loan agreement?

In **New Bank of New England v The Toronto-Dominion Bank** 768 F. Supp. 1017 (SDNY 1991) the court found that the plain language of the loan agreement allowed the majority lenders to exercise a discretion to accelerate the loan, which also meant they had a discretion not to accelerate the loan:

... Under the express language of the applicable agreements NBNE cannot compel the majority lenders to accelerate and foreclose.
As NBNE itself alleges:
The Intercreditor Agreement provides that the agent may act in certain circumstances in accordance with the directions of the majority lenders, that is, the holders of more than 50% of the unpaid debt under the Agreement. The Senior Credit Agreement contains a similar provision. For example, the Senior Credit Agreement provides that a majority of the lenders may require the agent to accelerate the loan upon specified events of default. Defendants TD Bank, Provident and Prudential together constitute majority lenders under both the Senior Credit Agreement and the Intercreditor Agreement . . . .
Here, a majority of the Lenders have not directed or required acceleration or foreclosure. The discretionary language of the operative documents authorizes them to refrain from doing so.
In Carondelet Sav. & Loan Assn. v. Citizens Sav. & Loan Assn., 604 F.2d 464 (7th Cir. 1979), a bank that had purchased a participation in a loan alleged that the selling bank had improperly refused to foreclose upon the borrower's default. The court held that where the participation agreement "specifically granted the [selling bank] authority to determine when to foreclose," the selling bank "clearly had the authority not to foreclose." 604 F.2d at 469. While the form of the loan participation at issue in Carondelet differed from the syndication in this case, and while the selling bank in that case had express authority under the agreement to act on behalf of all the participating lenders, Carondelet, nevertheless, establishes that the discretionary power to declare a default must also include the power not to do so....
NBNE asserts that while the agreements may not have expressly given it the right to insist on foreclosure, the explicit terms of the Credit Agreement and the Intercreditor Agreement must be interpreted as implying such a right.
Courts have generally refused to rewrite agreements to provide minority lenders with any rights, such as the "implied" right sought here by NBNE, which are not expressly set forth in the agreements..... Nor is there any basis for reading fiduciary or other duties into agreements "among sophisticated lending institutions."...
Indeed, to the extent that NBNE's claim against the other Lenders is premised on a purported "implied" covenant between the Lenders, NBNE has expressly waived such a claim. Section 9(d) of the Intercreditor Agreement .. specifically provides that none of the Lenders shall have any liability to each other for any action or omission in connection with, among other things, the Credit Agreement or the Intercreditor Agreement, "except as expressly provided" in those agreements. There is no question that such a limitation of liability among parties such as the lenders here is enforceable under California law. ..

In an effort to avoid summary judgment, NBNE has argued that the agreements must be considered ambiguous because the interpretation advanced by the moving Lenders has effectively created a stalemate: while Noble's default has not been waived, it has also not been acted upon. NBNE asserts that this stalemate could not reasonably have been contemplated by the parties, and that this indicates that the Lenders' interpretation does not reflect the parties' intentions when the documents were signed.
NBNE's proposed interpretation is that because the Credit Agreement requires NBNE's consent to a restructuring and because it will not agree to a restructuring but, instead, prefers to accelerate and foreclose, the majority lenders are required to agree to accelerate and foreclose.
However, the document specifically provides that upon Noble's default the vote of a majority of the Lenders is required in order to exercise the remedies of acceleration and foreclosure. There is no provision in the Senior Credit Agreement for a minority lender such as NBNE to compel such an acceleration and foreclosure, and indeed, no provision which even suggests such authority.
Where, as here, the meaning of an agreement among sophisticated parties is unambiguous on its face, the agreement does not become ambiguous simply because one of the parties later asserts that it intended a different interpretation...
Nor should the court read an ambiguity into an agreement merely because one of the parties becomes dissatisfied with its position under the plain terms of the agreement...
All of the circumstances indicate that the parties to these agreements were sophisticated institutions, dealing with the central issues of their business. As such, there is no basis to presume that they intended a result other than that required by the language of their agreements -- stalemate or not.
In addition, NBNE's assertion that the Majority Lenders have an "implied obligation of good faith" to accelerate and foreclose is barred by § 9(d) of the Intercreditor Agreement and Section 12.1 of the Credit Agreement, which states with respect to TD Trust:
no implied covenants, functions, responsibilities, duties, obligations or liability shall be read into this Agreement or otherwise exist against the Funding Agent.
In each of the cases cited by NBNE in support of this claim of "good faith obligation," the party alleged to have breached the implied duty of good faith either wrongfully exercised some contractual power to its exclusive benefit or wrongfully denied the existence of a contractual obligation, again to its exclusive benefit. Here there is no allegation that the other Lenders have acted in a fashion intended to benefit themselves at NBNE's expense, but only that the two sides disagree on which course of action will produce a better recovery on the troubled loan.
Thus, NBNE has no "right" to accelerate, nor is there any "promise" to accelerate. Acceleration is a remedy that can only be provided by -- and exercised in accordance with -- contract... The agreement here does provide for the remedy, but only where it is approved by a majority of the Lenders.
Nevertheless, although acceleration and foreclosure are contractual remedies which may not be exercised without a majority vote of the Lenders, NBNE is free to pursue its own remedies at law by suing Noble to collect on its debt to NBNE. Section 13.3 of the Senior Credit Agreement provides in pertinent part:

The rights, remedies, power and privileges herein provided are cumulative and not exclusive of any rights, powers and privileges provided by law or in equity...
In summary, the language of the controlling agreements is unambiguous and no implied obligation can be constructed, impasse or no...

Adherence To The Terms Of The Agreements Does Not Constitute Negligence Or Wilful Misconduct

With respect to NBNE's third claim, for negligence or wilful misconduct, the defendants again rely upon § 9(d) of the Intercreditor Agreement, which provides that no creditor "shall have any liability . . . except as expressly provided herein." Although such an exculpatory provision is to be strictly construed under California law ...even a strict construction of this language furnishes a defense to the Lender defendants here.

As for TD Trust, although Section 7(a) of the Intercreditor Agreement provides that the agent "shall be liable for its own gross negligence or wilful misconduct," the misconduct alleged is the failure of the Lenders other than NBNE to declare a default, rather than TD Trust's failure to act upon such a declaration. Since no duty is owed to NBNE to declare a default, the failure to make such a declaration does not constitute negligence.

In an English case, **Redwood Master Fund Ltd v TD Bank Europe Ltd** [2002] All ER (D) 141, Rimer J. refused to hold that the majority lenders' power to vary the terms of a syndicated loan agreement[10] was subject to an implied term that the power would be exercised bona fide for the benefit of the lenders as a whole because such an implied term did not reflect the intention of the parties, and such a restriction on the power to vary the agreement might be unworkable. Rather the court should assess whether the power was being exercised in good faith for the purpose for which it was conferred. I am including a very long excerpt from this decision because the facts are very complex. But note that this case is related to the issues in the Elliot cases we looked at earlier and the EMCA model clauses. Any time there may be conflicts between the interests of different groups and a majority has the power to decide outcomes these issues will arise (this is like the close corporation situation where a majority's power to take action may be limited by reference to ideas of good faith). Consider the excerpts from the judgment. Do you agree with the judge about the appropriate approach to this issue?

9. Clause 2.1 of the facility agreement provided for three separate facilities to be available to the borrowers: Facility A (hereafter, but not always, simply "A"), a revolving credit facility of Euro 750m; Facility B ("B"), a term facility of Euro 2.75 billion; and Facility C ("C"), a term facility of US$3475m and Euro 95m. Schedule 1, Part II, set out the proportions in which each lender assumed commitments under the three facilities. Fifteen of the 38 lenders assumed C commitments; and 26 lenders (including three who had assumed C commitments) assumed A and B commitments: no lender assumed an A or B commitment without also assuming the other. The amounts of the A and B commitments varied as between the lenders, but in each case the lender's B commitment was 3.66 times the amount of its A commitment, with each lender holding the same proportionate A commitment as it did a B commitment. That is of some significance, because if the position had remained the same down to the time of the modified waiver letter, it is improbable that any complaint of the type raised in this action could have arisen. The complaint has arisen because, since the date of the facility agreement, the commitments have been the subject of dealings on the secondary debt market, so that the position by the time of the modified waiver letter was that not all lenders held similarly

[10] The borrower in this case was United Pan-European Communications NV.

proportionate A and B commitments. By then, a minority in number and value of lenders (including the claimants) held only A commitments, or else held A commitments in proportions exceeding those of their B commitments....

The cross-default

22. UPCNV was due to pay interest on its bonds on 1 February 2002, although it had a period of grace (expiring on 3 March -2002).within which to pay. By January 2002, a question had arisen as to whether it would pay that interest. Its failure to do so would constitute a cross-default under the facility agreement for the purposes of clause 18. Subject only to any agreed waivers which might be agreed under clause 25, the effect of that would be, amongst other things, to absolve the lenders from any obligation to make further advances under the facility agreement. This was because the cross-default would be an "event of default" under the facility agreement for the purposes of the condition precedent imposed by clause 4.2(b). In addition, any such default would subject the borrowers to the risk of the acceleration provisions of clause 18.21.

23. The risk of a default in the payment of the interest due on the bonds - and the default itself when in due course (as it did) it happened - were therefore potentially serious, matters as regards the UPCD group, which was dependent, for its cash needs on the facility agreement. They were of course also potentially serious matters for UPCNV itself, and they led to negotiations between UPCNV and its bondholders with a view to UPCNV's capital restructuring. These negotiations occupied the succeeding months, until eventually on 30 September 2002 a formal agreement was concluded as to the way forward, although it was not one that finally resolved the matter. The achievement of the proposed restructuring was going to, and still does, require both Chapter 11 proceedings in the USA, and "Akkoord" proceedings in the Netherlands.. The action is concerned solely with the effect of UPCNV's cross-default on the UPCD facility agreement, and the steps taken since February 2002 by the majority lenders to grant UPCD a waiver of the consequences of the default. Those steps resulted in the granting of a series of short-term temporary waivers, expiring on 27 September, and ultimately in the modified waiver letter signed on that day, about which the claimants complain.

The original waiver letter

24. Recognising the problems which would arise in the event of a cross-default by UPCNV, towards the end of January 2002 Mr Okhuijsen (the treasurer of the UPC group, including UPCD) and Mr Evans (a managing director of the legal department of UPCNV) contacted Mr Bingham and Mr McPherson of the TD Bank group, in particular in their capacity as spokesmen for TD Bel, the facility agent. They warned of the risk of a cross-default and asked TD Bel to take the lead in co-ordinating the banks' response to UPCD's request for a waiver of the default provisions should the need arise. On 1 February, Mr Okhuijsen told Mr M0herson that UPCNV would not be making the interest payments due on that day.

25. As a result of this, TD Bank and another lender, J P Morgan Chase ("JPMC"), decided that an ad hoc committee of lending banks would need to be established to conduct the waiver negotiations on behalf of the lenders generally. The first meeting . of the lenders took place on 6 February. TD Bel convened the meeting, by notice given only to those lenders entitled to receive non-public information about UPCD's finances. This circulation was so restricted because the meeting would be discussing such non-public information. I shall, for brevity, refer to this class of lenders as "non-public lenders." The reason that other lenders ("public lenders") were not entitled to the like information was because they traded in public securities, and for them to trade in UPC group stocks whilst in possession of non-public information could put

them in breach of SEC regulations. This was not necessarily a bar to their receipt of such information, provided that they had first set up necessary Chinese walls or other mechanisms enabling them to receive it, but the onus was on them to notify TD Bel (as facility agent) they were so able. In fact, only a small percentage of lenders were public lenders. The only claimants who were parties (by novation) to the facility agreement at this stage were Goldentree MF and Goldentree Opportunities (the fourth and fifth claimants): the former held Euro 3 53m of B paper and the latter held Euro 1m of A paper. As they had not notified TD Bel that they were entitled to receive non-public information, they were not on the circulation list for the meeting.
26. I find that as early as this meeting the lenders expressed their wish that a term of any waiver to be granted to UPCD should be the overall reduction of the facility (it is the facility reduction that was ultimately achieved by the modified waiver letter which has given rise to all the trouble). The meeting approved the establishment of an ad hoc co-ordinating committee of lenders ("the CCL") comprising TD Bank, JPMC, The Royal Bank of Scotland Plc, Fortis Bank (Nederland) NV and Bank of America NA. The CCL's function was to negotiate with UPCD on behalf of those lenders supporting its role ("the consenting lenders'), which in fact represented an overwhelming majority in value of all lenders. The negotiations were conducted primarily by Mr Bingham and Mr McPherson (both of TD Bank) for the CCL and Mr Evans and Mr Okhuijsen for UPCD.
27. These negotiations led to the agreement of a temporary waiver on the terms of a letter from TD Bel to UPCD dated 1 March 2002 ("the original waiver letter). UPCNV had not in fact committed a cross-default by then (because the grace period was still running) but it did commit it on 3 March, when the period expired. The letter, therefore, strictly operated as an anticipatory waiver of the consequences of UPCNV's expected default. The waiver was for a limited period expiring on 3 June 2002 at the latest: subject to any further waivers, it would then be open to the lenders to exercise all their rights under the facility agreement.
28. The letter reflected the views of the consenting lenders. It referred to the establishment of the CCL. It imposed various conditions on UPCD. One was that by 1 March 2002 Euro 100m of outside money should have been injected into the UPCD group, by way of capital or subordinated loans, and Belmarken duly provided this cash. Another was that (subject to certain conditions) UPCD could draw a maximum of Euro 100m under Facility A (which was still wholly undrawn), for the purpose of applying such advances in the ordinary course of the business of the UPCD group. UPCD had to provide certain management information, business plans and budgets to the CCL, and Deloitte & Touche ("Deloittes") were to be appointed to review UPCD's business plans and forecasts on behalf of the CCL. The letter reflected that steps were being taken towards the restructuring of UPCNV's indebtedness.
29. On the same day, 1 March, the CCL issued a letter to lenders seeking their formal consent to CCL playing a continuing co-ordinating role, the letter envisaging (as happened) that TD Bank and JPMC would act as co-chairmen of the CCL. 94% in value of the lenders signed, up to the letter. Of the balance of lenders who did not. 3% had confirmed that they were only public lenders. The third to fifth claimants (HCM/Z, Goldentree MF and Goldentree Opportunities) subsequently signed up as well, and so received all non-public information circulated to lenders. Very much later, so did Redwood, the first claimant.

The claimants' acquisition of Facility A paper
30. The action is based on the claimants' complaint that the modified waiver letter later signed on 27 September 2002 discriminated against them as holders of A paper, and was manifestly unfair towards them. The heart of the complaint is that it entitled UPCD to draw on A solely for the purpose of prepaying part of the B drawings, at a time when (a) but for any waiver UPCD

could not draw on A at all; (b) even with an unconditional waiver, the covenant restrictions prevented it from drawing sufficient A funds to make the prepayment; and (c) pending the completion of the restructuring of UPCNV (which was not expected to be achieved, if at all, before the end of March 2003), the solvency of UPCD was in doubt. The claimants make other complaints as well, to which I shall come, but I must first summarise the commitments the claimants acquired under the facility agreement, and when they did so.

31. Redwood bought Euro 14m of B paper on 8 February 2002, and Euro 7m of A on 9 April. It sold Euro 5m of B on 18 April and bought a further Euro, 5m of A on 3 July. At the date of the modified waiver letter, it held Euro 12m of A and Euro 9m of B. Gracie started acquiring and selling A and B paper on 10 May 2002. At the date of the modified waiver letter, it held Euro 7.5m of A and Euro 2m of B. HCM/Z bought Euro 5m of each of A and B paper on 16 April 2002, but sold the latter on 31 July. At the date of the modified waiver letter, it held Euro 5m of A, and no B. Goldentree MF purchased Euro 3.53m of B paper on 30 November 2001, and a further Euro, 1m on 15 February 2002. It sold all its B paper on 19 April. On 10 May, it started purchasing A paper. At the date of the modified waiver letter, it held Euro 22.12m of A, and no B. Goldentree Opportunities purchased Euro 1m of A paper on 30 November 2001, and bought a further holding of Euro 2m on 15 February 2002. It sold the lot on 18 April, but then bought Euro, 4.6m of A on 30 August, which it also held at the date of the modified waiver letter. It had no B paper. Seneca started acquiring and selling A and B paper on 8 April 2002. At the date of the modified waiver letter, it held Euro 15m of A and Euro 4m of B.

32. Each claimant therefore held either only A paper, or else (as between A and B) predominantly A paper (meaning a greater percentage of A paper than of B paper). Each acquired the A paper it held at the date of the modified waiver letter with knowledge of UPCNV's cross-default and of the original waiver letter. At the time of each relevant (post cross-default) purchase, the A paper was trading on the secondary debt market at a discount of some 35%, and the claimants were paid a reverse premium reflecting that discount to take on their A commitments. Expressed generally, since the evidence does not disclose precise figures, for each Euro 100 they became committed to lend, they were paid about Euro 35.

The events leading to the signing of the modified waiver letter

33. A meeting of the consenting lenders took place on 16 May, at which UPCD and Deloittes made a presentation. Its purpose was to enable the lenders to learn about UPCD's projections for the future and determine the basis on which any extended waiver might be granted. HCM/Z was present (represented by Ivan Zinn), being the only non-public claimant at that stage.

34. The UPCD projections presented to the meeting showed that its total drawdown under the facility agreement would not exceed Euro 3.38 billion after 2002, and projected a drawdown of A in 2004 in order to make the first repayments then due under B and C. Various lenders made renewed requests for a reduction in the facility. Mr Bingham said in evidence that they included CIBC, and probably Goldman Sachs and Morgan Stanley. He said that support for such a reduction from others at the meeting was apparent.

35 I find that the lenders assumed that any such reduction would simply be in the undrawn facility. A was wholly undrawn, and Euro 70m of B was also undrawn, although B and C were otherwise fully drawn. Most lenders had interests in both A and B, and so a cancellation of the undrawn facilities would be in their interests. On 30 May, Mr McPherson of TD Bank circulated to the consenting lenders a list of the so-called "Asks" they had raised at the meeting. Items 1 and 15 referred respectively to "No further advances under the Facility Agreement" and "Facility reduction to reflect revised business model." The CCL's recorded response was that its assessment was that UPCD was unlikely to agree to a facility reduction.

36. On 31 May, the temporary waiver effected by the original waiver letter was further extended for a short period. I need not detail its terms, nor those of the subsequent further temporary waivers granted by TD Bel letters of 17 June, 1 July, 15 July, 29 July, 12 September and 23 September. The need for these renewed temporary extensions was to allow sufficient time for UPCNV to reach agreement with its bondholders as to the way forward to a capital restructuring of UPCNV.
37. On 11 June, TD Bank made a further note referring to the lenders' "Asks", including a reference to the request for the facility size of "Euro 4 billion to be [reduced] to a lower amount given the revised business plan [which] shows a peak borrowing of Euro 3.4 billion." TD Bank's recorded comment in relation to that was that UPCD's management had previously stated that it planned to retain the facility at its then level, so as to provide it with long term flexibility. This note was circulated to the consenting lenders, including HCM/Z. On 13 June, Goldentree MF and Goldentree Opportunities joined with other lenders in confirming the role of the CCL and signed confidentiality letters with UPCD enabling them to receive non-public information.
38. On 23 July, UPCNV reached an agreement in principle with its external bondholders for a capital restructuring (UPCNV's major bondholder was UGC). A meeting of the consenting lenders (representing some 97% in value of the facility commitments) took place the following day. HCM/Z, Goldentree MF and Goldentree Opportunities were invited to it, but it is not clear whether they attended. UPCD, UPCNV and the advisers to the bondholders' steering committee were at the meeting. Those advisers outlined to the lenders the basis of the agreement that had been reached for the restructuring, and explained the method by which it was to be achieved and the timing of the steps to be taken to achieve it. The restructuring was to involve an exchange of debt for equity.
39. UPCD, UPCNV and the advisers then left, and Mr Bingham made a presentation to the lenders explaining why a further temporary waiver was required. He says a number of lenders again asked for a reduction, of the facility, and also for an upward negotiation of the commissions and margins payable under the facility agreement. Other lenders expressed concern as to whether UPCD could meet its financial covenants in and after the first quarter of 2003, and proposed that these should be revised so as to be in line with its business plan. The current waiver was due to expire on 29 July, and the lenders agreed a further 45-day extension so as to enable UPCNV to document its restructuring agreement with the bondholders. Mr Bingham assumed that any facility reduction would be in the undrawn A, and the inference is that the other lenders did as well.
40. On 8 August, Mr McPherson of TD Bank sent an informal list of the lenders' "Asks" to Mr Okhuijsen and Mr Evans of UPCD. Item 10 read "Facility Reduction/Pricing TBA". This led to a discussion on 9 August between Mr Okhuijsen and Mr Bracken of UPCD, and Mr Bingham and Mr M0herson of TD Bank. The former said that UPCD could not agree to any reduction in the facility, or to its repricing, and that the CCL would have to discuss these matters with UGC and UPCNV's bondholders.
41. This led to discussions over the following days between Mr Bingham. of TD Bank and Mr Fries of UGC, and to a meeting in Denver on 20 August between Mr Bingham, Mr Fries and Mr Schneider (also of UGC). Mr Bingham recorded the outcome in an e-mail he sent to Mr McPherson on 20 August. He wrote that "After we got past the threat of nuclear war" - suggesting the negotiations had not been easy - agreement was reached in principle that a continued waiver would be granted until the closing of the restructuring. Three conditions were to be imposed on UPCD immediately upon the grant of such waiver: (i) the payment to the lenders of a waiver fee of 0.25 basis points, to be paid by a drawdown on the UPCD bank facilities (presumably A); (ii) an increase in the margin on all facilities by 150 basis points; and

(iii) "Availability decreased by Eur 50OMM." This last was of course a reference to the agreed Euro 500m reduction in the facility (a Euro 4 billion one), which was in line with UPCD's projections showing a peak borrowing need of Euro 3.38 billion. Four further conditions were to be imposed on UPCD once the restructuring was closed. The only ones I need mention are those providing for a relaxation of the ratios by reference to which UPCD was able to draw on the facility, and the injection of Euro 125m cash into UPCD for equity. The evidence also includes an e-mail of 20 August from Mr Fries to Mr Okhuijsen and Mr Evans, setting out the terms of the agreement from UGC's perspective. He described four points as having been agreed, including "Availability: Reduced by 500 million (at time of waiver)", and three others as still under discussion.

42. I comment that in agreeing a Euro 500m reduction, Mr Bingham had to some extent departed from the consenting lenders' and the CCL's instructions. Both bodies had been aiming for a reduction of about Euro 400m, but Mr Bingham argued for a Euro 500m one, on the basis that he expected to be negotiated down. In the event, Euro 500m was achieved, and he did not suggest to UGC that a lower reduction would do. Mr Brisby made some point of this, but of course when the matter was put to the consenting lenders at their next meeting, on 4 September (to which I shall come), they knew the precise amount of the proposed reduction, and how it was to be effected, and raised no objection or concern about it.

43. Mr Bingham's evidence was that, although UGC had by now agreed a Euro 500m reduction in principle, it insisted that the details as to how it was to be effected, in particular its allocation between A, B and C, were to be decided by UPCD. Mr Bingham said that UPCD made it plain that it could not continue in business if the whole Euro 500m reduction was effected in A, and he realised by now that, contrary to his original assumption (and, I find, that of the lenders generally) UPCD would not agree to the reduction being effected simply by cancelling the undrawn facilities.

44. Following this, UPCD promptly devoted itself to working out how a Euro 500m facility reduction could be achieved consistently with its projected cash needs. Mr Okhuijsen asked his assistant, Mr Nooij, to prepare a financial model and he asked him to show the cancellation as all coming off B. Only Euro 70m of B was undrawn, so that any such cancellation would also require a minimum prepayment of Euro 430m of the B drawings, which could only be done by drawing on A. But the advantage to UPCD of achieving the reduction by this route was simple, namely that as the B repayments due in 2004 were a percentage of the outstandings as at 31 December 2003, it would assist UPCD's cash flow projections if those outstandings could first be reduced as much as possible. I find that UPCD took the view that it had a right under clauses 72 and 7.3 of the facility agreement to draw, cancel and prepay in this way, although it appears to me that such a view was strictly misplaced. This was because, at the time, UPCD was in default and was only enjoying a temporary waiver. The terms of any extended waiver were dependent on agreement with the lenders, so that UPCD's rights under the facility agreement were more limited than it may have thought.

45. At the same time as UPCD was working on its own financial model, TD Bank was working out for itself how the facility reduction might be achieved. By 22 August, Mr McPherson had calculated that, in light of UPCD's figures for 2003 and 2004 (UPCD had not provided figures for any later years), the reduction would have to fall mainly on the drawn facilities (B and C) and not just on the undrawn A, and so would require some prepayments. At 1.37 pm on 22 August, he sent an e-mail to Mr Bingham. enclosing a model he had prepared, saying that it "shows all B but to make it work cash flow wise it will probably be Euro 100 A, Euro 350 B and Euro 50 C. (B & C don't make much difference but I think we need to offer something to get the C lenders onside)." His last comment reflected that the proposed reduction would necessarily involve

prepayments of drawn facilities, and the 'lenders' support for the proposal might depend on their being given a share of it.

46. On the same day, 22 August, Mr Nooij told Mr Okhuijsen that his further thoughts revealed that UPCD's repayment profile would be substantially improved if the reduction were effected by cancelling Euro 83m of A and Euro, 417m of B. Mr Okhuijsen was satisfied that this was the optimal solution and he telephoned Mr McPherson that evening to tell him. Mr Nooij and Mr McPherson had, therefore, been independently thinking along similar lines. Mr Okhuijsen explained in evidence that the benefit of the proposed allocation was that it optimised the repayment profile under the facility agreement, and hence UPCD's ability to continue in business and ultimately to repay all lenders in full.

47. At some uncertain point TD Bank had raised with UPCD that part of any prepayment should also be allocated to the C lenders, but on 23 August, Mr Nooij advised Mr Okhuijsen that there was good reason for not prepaying and cancelling any of C, namely that it would result in higher repayments in 2004 and 2005 (the detailed reasons why do not matter). On the same day, Mr Okhuijsen sent TD Bank a revised model showing the proposed cancellation of A and B, and the prepayment of the latter. The model showed the drawdown on A that would be necessary in order to make the B prepayment. Mr Okhuijsen also spoke to Mr Bingham and Mr McPherson on the telephone, although according to Mr Okhuijsen their conversation did not concentrate on the allocation of the facility reduction, and he says that Mr Bingham and Mr McPherson expressed no concern about it. It focused rather on UPCD's short term liquidity needs, the banking covenants and its ability to carry out currency and interest hedging. This aspect of the discussion (relating in particular to the banking covenants) was directed to enabling UPCD -to draw down in 2002 the full Euro 100m provided for by the original waiver letter rather than just Euro 67m, which was the limit in practice permitted by the constraints of the covenants. Mr Bingham's evidence was that he agreed with Mr Okhuijsen that TD Bank would put Mr Nooij's model to the CCL for discussion and consideration. Mr Okhuijsen accepted in cross-examination that he explained during this conversation that nothing would be going to the C lenders.

48. On 27 August, Mr McPherson circulated to the CCL members his perception of the details of the terms of the proposed waiver. These included the waiver fee to lenders, the margin increase and a Euro 500m reduction. As to the last, Mr McPherson said that exact split was yet to be confirmed, but was:

"... likely to comprise Tranche A reduced by Euro 83.3MM (11.1%), Tranche B Euro 366.7 MM (13.3%) and Tranche C Euro 50 MM (11.3%). Please note any voluntary prepayment/cancellation does not have to be made on a pro-rata basis as the company has the option of prepaying/cancelling individual tranches (Clauses 7.2 & 73 of the Facility Agreement)."

49. Mr McPherson explained further that, in consideration of agreeing to this, the lenders would be asked to agree to a covenant relaxation so as to enable Euro 100m to be available to UPCD during 2002. He explained that UPCD was in the course of obtaining bondholder approval to the package, and that the CCL should contemplate distributing it to the lenders prior to the meeting fixed for the following week. It appears that, although UPCD was clear (and had already told TD Bank) that the optimal allocation of the Euro 500m reduction could not include the C lenders, TD Bank was of the continuing view that it might be necessary to throw them a bone in order to enlist their support.

50. On about 3 September, Mr Okhuijsen spoke to Mr McPherson on the telephone. He said that UPCD had decided that the split would be exclusively between A and B, with the cancellation of Euro 83.25m of A and Euro 416.75 of B, and the prepayment of Euro 346.75m of the latter (the balance of Euro 70m being undrawn). Mr Okhuijsen explained that UPCD

would draw on A in order to make the prepayment of B. There is some uncertainty as to the precise timing of this conversation, which Mr Bingham suggests was only very shortly before the holding of the lenders' meeting which took place in London on 4 September.

51. Mr Bingham. says he explained to the lenders at the meeting UPCD's proposed allocation of the Euro 500m reduction, about which they raised no questions or objections. This was the first time it had been put to them that the overall facility reduction that they had wanted from the outset would be effected by prepaying part of B by drawing on A. Mr Brisby made the point that TD Bank should have gone back to the lenders during the last week of August and explained to them that a Euro 500m reduction could not be effected simply in the undrawn facilities, but would have in part to be allocated to the drawn part. But I do not see why the matter could not have waited the few additional days until this meeting. Mr Bingham says that, following this meeting, there was a conference call with the US consenting lenders, so that they could be party to the presentation which had been made at the meeting. Mr Zinn, on behalf of HCM/Z, participated in this call. Questions were asked about the allocation, and Mr Bingham responded that UPCD had the right under the facility agreement to allocate any cancellation or reduction amongst the three facilities as it thought fit. In saying so, he appears to have shared UPCD's view, although for like reasons I have already given I regard Mr Bingham's view as similarly misplaced.

52. On 5 September, Mr Haddad, on behalf of Goldentree MF and Goldentree Opportunities, telephoned Mr McPherson of TD Bank. He said he was not happy with what he called "the split" - the allocation of the reduction between A and B - and complained that TD Bank may have acted improperly. He was complaining that B was receiving a disproportionate share of the overall reduction, although he did not assert that the facility should not be reduced at all, or that any such reduction should be deferred until the restructuring of UPCNV had been finalised. Mr McPherson replied that UPCD had decided on the split, not TD Bank. Both Goldentree funds held only A paper. The effect of the proposal was that they would be required to suffer draw downs for the sole purpose of prepaying B. So, of course, would the other A lenders, but as regards most of them, and having regard to the relative size of their B holdings, that would have either a cash positive or, at worst, a neutral effect. This proposal was ultimately incorporated into the modified waiver letter, despite the claimants' objections, and I shall explain later in more detail its effects on the various lenders. On the same day, Mr Jonathan Kolatch of Redwood telephoned Mr McPherson and made complaints about the waiver fees being too low and that the banks were "rolling over."

53. It was only. at this point in the course of the negotiations with the lenders that TD Bank realised for the first that some lenders, like the two Goldentree funds, were A lenders only. None of the CCL members held only, or predominantly, A paper. There is no evidence as to what any of the lenders knew as to the extent to which there were lenders holding only, or predominantly, A paper. Mr Bingham admitted in cross-examination that "in hindsight" it could be said that the prepayment of B, was not in the interest of such A lenders. He explained that this was only "in hindsight" because it was not until about 5 September that he learned that some lenders held only A. But the modified waiver letter was not signed until 27 September, and in the meantime specific consideration could, had the CCL chosen to do so, been given to the interests of this sub-class of A lenders. Even by 5 September, Mr M0herson does not appear to have appreciated the potential effect of the reduction on certain A lenders. On that day he sent an e-mail to Gregory Hurley of TD Securities, saying:

"...In effect the split over Tranche A & B is no different to a cancellation of Euro 500 MM undrawn commitment under A as this will be drawn to reduce B. The split between the two tranches was determined by the company to give them the optimal maturity/repayment profile

that they could achieve given the reduction being made. As Tranche A & B were sold to the bank market on a pro-rata basis it makes no difference to the lenders which tranche is cancelled."
Had A and B still been so held, Mr M0herson's last remark would have been right. But they were not, and it was wrong.
54. On 6 September, TD Bel sent all the non-public lenders a letter setting out the terms of the proposed modified waiver letter, of which it enclosed a draft. This reflected the method of facility reduction that had been agreed with UPCD. The letter explained that the UPCNV restructuring negotiations were on course, and that it was expected that the final document would be signed by the proposed effective date of the waiver, namely 16 September. It asked for letters of consent to the modified waiver letter to be returned by 12 September. Also on 6 September, TD Bel circularised a fax letter to all public lenders, setting out the essential terms of the proposed further waiver. The lenders so circulated included Redwood, Gracie, Goldentree MF and Seneca. The explanations in this letter were short. It referred to the fact that UPCD had requested an extension of the current waivers until the earlier of 31 March 2003 or the completion of UPCNV's restructuring process. It explained that the letter was including only public information, and was not including a draft of the proposed waiver document, although it said that its understanding was that the document would be submitted to the SEC in due course. It summarised some of the proposed changes to the facility agreement, namely (i) the payment of 'a waiver fee to each lender on the earlier of the completion of the restructuring or 1 April 2003, (ii) an increase in the margin as from 16 September 2002, and (iii) a Euro 500m reduction to the facility by reducing A by Euro 83.25m to one of Euro 666,750,000m; and by reducing B by Euro 416.75m to Euro 2,333,250,000, involving a repayment of Euro 346.75m. It did not explain that the prepayment would be funded by a draw down on A, although Mr Bingham, suggested, and I consider he was right, that the readers of this letter would have assumed this. The letter also pointed out that there were to be some changes in the financial covenants in the facility agreement. It similarly asked the lenders to signify their consent to the proposed waiver by 12 September.
55. By 11 September, it was clear that there was to be a further delay in the agreement of the UPCNV restructuring document. TD Bank circulated the lenders again, saying that there would be a further short temporary extension of the current waiver to 23 September.
56. On 12 September, Cadwalader, Wickersham & Taft ("Cadwalader'), the claimants' solicitors, entered the scene. They wrote to TD Bel as facility agent. They identified themselves as acting for a group of ten lenders, including the claimants. They were responding to TD Bel's letter of 6 September (written to the public lenders) inviting consents to the proposed modified waiver letter. They summarised the proposals. They said that TD Bel was faced with a conflict of interest. They said the proposals were not in the A lenders' interests, and complained that no-one had been appointed to represent their interests. They asked for an agent to be appointed as a matter of urgency. They said the proposal to use A advances to prepay B advances was not permitted by clause 3.1(a)(i) of the facility agreement. They said the proposals operated to extend the A commitments, a matter which was the subject of the entrenched provisions of clause 25.2 (a point Mr Brisby conceded was bad). They asked that the proposed waiver letter should be made public so that their clients could make informed judgments on it.
57. On the same day, 12 September, Mr Haddad (of Goldentree MF and Goldentree Opportunities, and who was also interested in four other funds holding A paper) wrote to Mr McPherson asking for representation on the CCL. His. request was considered by the CCL on 13 September. The CCL did not reply in writing to Mr Haddad, but Mr Hurley of TD Securities

spoke to him on the telephone, when Mr Haddad requested the convening of a meeting of lenders to consider the position of the A lenders. Mr Bingham considered this to be excessive and declined to take this step, but said he raised Mr Haddad's points with the CCL at its meeting on 13 September. The CCL's view was that it would be counter productive to open up Mr Haddad's points. Mr Bingham's elaboration of this in his evidence was that the CCL considered that it was for UPCD to decide how to allocate the reduction between the three facilities, and they also had in mind that any debate about the respective positions of the A and B lenders would be likely to provoke the C lenders into asking for a slice of the reduction. The overall view was that this would all lead to a delay in getting a deal with UPCD, which would not have helped anyone, and in particular would not have helped the negotiations between UPCNV and its bondholders about the restructuring. Mr Bingham's evidence was that the CCL considered that this could have jeopardised the restructuring. The CCL's conclusion was, in Mr Bingham's words, that "there was too much to lose and nothing to gain in reopening the issue as to how the reduction was to be allocated as between the tranches. UPCD had been very adamant throughout that they would only accept a reduction of the facility if they were allowed to allocate it as between the tranches." Nor was the CCL prepared to agree that Mr Haddad should have a representative on it.
58. On 13 September, Redwood opted to receive non-public information relating to UPCD.
59. Allen & Overy, TD Bel's solicitors, replied on 17 September to Cadwalader's letter. They denied that TD Bel had a conflict of interest. They denied that the proposals involved any breach of clause 3.1(a)(i) and said that anyway the majority lenders could consent to any necessary amendment of that provision. They denied that the proposals involved anything requiring the unanimous consent of the lenders. They said that TD Bel disagreed that the draft modified waiver letter should be made public.
60. On 19 September, TD Bank circulated to the non-public lenders a draft of the modified waiver letter in its nearly final form. On the same day, they also circulated the public lenders. They invited all lenders to consent to a short extension of the current waiver from 23 to 27 September, and to consent to the modified letter itself. They asked for the consents to be returned by 23 and 27 September respectively.
61. Cadwalader replied to Alien & Overy on 20 September. They pointed out that all their clients held A commitments exceeding their B commitments (if any) and that the proposed facility reduction and prepayment would have the effect of reducing the B exposure whilst increasing the A exposure. The wrote that:
"Outstandings under the Facility are currently trading at a substantial discount; any further Advances made by [Cadwalader's A clients] would represent an immediate loss of capital value, whilst the opportunity to take a substantial prepayment in circumstances where such monies would not ordinarily be payable represents a considerable windfall to the Facility B lenders."
They pointed out that the majority lenders' power to waive defaults did not permit them to exercise their powers in a way prejudicial to the minority, and they referred to the decision of the Court of Appeal in Greenhalgh v. Arderne Cinemas Ltd. and Others [1951] Ch 286, in particular to what Sir Raymond Evershed MR said at page 291 (a passage to which I shall come). They stood by their points in their earlier letter and said that "Notwithstanding the purpose clause, our clients cannot against their wishes be taken from a position where their commitments cannot be drawn due to default, to a position where they can be required to make further Advances." They said their clients reserved all their rights in respect of the implementation of the restructuring (a reference to the proposed modified waiver letter, not to UPCNV's restructuring), "including the right to withhold and/or cancel the funding of the undrawn Commitments."

62. On 23 September, a further short extension of the waiver was granted until 27 September, so as to enable the UPCNV restructuring document to be finalised. Allen & Overy replied to Cadwalader's letter on 25 September. They devoted two pages to disagreeing with Cadwalader's assertions, but I find it unnecessary to detail the points they made. None could be said, on their face, to have irrefutably trumped all the cards Cadwalader had played.
63. By 27 September, the CCL had received the overwhelming consent of the majority lenders (81.76% in value) to the modified waiver letter, and on that day TD Bel circulated a copy of the final form of the letter, as signed, to lenders. The letter became effective on 30 September: paragraph 11 made it conditional on evidence that the UPCNV restructuring agreement had been signed by all parties, and it was then that the condition was satisfied. Also on 30 September, Cadwalader replied to Allen & Overy, saying they did not consider that the majority lenders had authority to give effective directions in relation to the waiver. On the same day, they copied to UPCD the correspondence they had written to Allen & Overy, and asserted that they considered the waiver to be ineffective.

The Modified Waiver Letter dated 27 September 2002

64. This is a letter from TD Bel to UPCD. It recites that its effect was to extend until 31 March 2003 the temporary waivers hitherto in place, and that the reason the majority lenders had agreed to it was to allow time for the completion of UPCNV's restructuring. As I have said, that was going to require both Chapter 11 proceedings in the USA and "Akkoord" proceedings for a compulsory composition in the Netherlands. In so far as the proceedings towards a restructuring might themselves constitute events of default under the facility agreement, they were to be waived until 31 March 2003, and would be permanently waived if the restructuring went through, when the slate would be wiped clean. Otherwise any such defaults would thereupon cease to be the subject of any waiver.
65. A principal purpose of the modified waiver letter was to reduce the level of the facility available under the A and B commitments. This was dealt with by paragraph 5, headed "Voluntary prepayment and reduction of Commitments". By paragraph 5.1, UPCD gave notice to TD Bel (as Facility Agent) of:
"...cancellation of a total of Euro 500,000,000 of the Total Facility A Commitments and the Total Facility B Commitments in the amounts set out in Schedule 1 and prepayment of the Facility B Advances in the amount set out in Schedule 1 (being the amount necessary to ensure that the drawn amounts under Facility B do not exceed the Total Facility B Commitments following the above cancellation)."
66. Schedule 1 provided for the cancellation of Euro 83.25m of the A commitments, and Euro 416.75m of the B commitments, the total cancellation therefore being of Euro 500m. Schedule 1 further provided for the prepayment of Euro 346.75m of the B advances, such prepayment being necessary in order to ensure that the amounts then outstanding under B did not exceed the total B commitment as reduced.
67. The cancellation and prepayment were to take place on 7 October 2002. Paragraph 5.3, of the letter provided that:
"(a) For the avoidance of doubt, it is agreed that amounts may be drawn down under Facility A for the purposes of repaying all of the Facility B Advances referred to in Schedule I."
That was included to remove any doubt as to whether. but for it, UPCD would have been entitled under clause 3.1(a)(i) to draw on A in order to pay B.
68. Paragraph 6 of the letter provided for the payment of a waiver fee to TD Bel within five business days of the completion of the UPCNV restructuring, the fee to be distributed between all lenders pro rata to their then respective commitments. That was, therefore, in effect a

conditional obligation, as was the provision in paragraph 8 requiring UPCD, within two business days of the completion of the restructuring, to procure the injection into UPCD of Euro 125m of cash, either for equity or by way of subordinated loans.
69. Schedule 2 to the letter made certain amendments to the terms of the original waiver letter. Schedule 3 imposed certain amendments to the facility agreement, including the deletion of clauses 4.3(a)(ii) and 4.3(b) of the facility agreement, which were necessary in order to vary the existing financial covenants so as to enable UPCD to draw down the A funds with which to make the B repayments (their current effect limited the available A drawings at that point to Euro 67m). Paragraphs 7 and 8 of Schedule 3 increased the margin. Paragraph 11 modified the provisions of clause 17 of the facility agreement so as to relax the conditions under which UPCD was entitled to call for a draw down under the facilities.

Subsequent events
70. On 2 October 2002, UPCD served notice of cancellation of Euro 83.25m of the A commitments and of Euro 416.75m of the B commitments, and on the same day it served notice of intended prepayment of Euro 346.75m of the B advances. In order to have the cash with which to do so, it served a request on the A lenders for an advance of Euro 346.75m on 7 October.
71. All A lenders honoured this request apart from the six claimants and three small funds who either are, or were, represented by Cadwalader but who are not claimants in this action. The shortfall arising from the claimants' default was Euro 283m. UPCD funded the shortfall from its other cash resources and by a short-term loan of Euro 14m from TD Bank. In order to repay TD Bank, and to have enough for its other working capital needs, UPCD made a further A draw down request, for payment on 14 October. This was for Euro 25m, but again the same nine lenders refused to honour it. The shortfall arising from the claimants' further default was Euro 2.2m. On the other hand, on 21 October UPCD also made a draw down request on the A lenders of further funds for working capital purposes. The payment was due on 25 October. The claimants did honour this request, albeit late, by making the requested advances on 28 and 29 October. Since such drawdowns could only be made under the modified waiver letter, whose validity the claimants challenge, those payments reflect an inconsistent stance on their part, although they were apparently paid without prejudice to their overall position that the modified waiver letter does not bind them. I did not understand it to be suggested that the making of those payments served to put the claimants out of court in this action.

The effect of the modified waiver letter on the various lenders
72. The evidence includes a schedule recording the "funds flow" on 7 October, the date on which the A lenders were required to honour the request for Euro 346.75m in order to enable UPCD to prepay that sum to the B lenders. The schedule lists 46 lenders with A and/or B commitments. 31 lenders had both A and B commitments; seven had only A commitments; and eight had only B commitments. It also lists six lenders with C Euro commitments, one of which also had A and B commitments, and the other of which was only in B. Of the, 46 A and/or B lenders, 29 consented to the modified waiver letter, three indicated that they did not consent to it, and no response either way is recorded against the other 14 (which last class includes the claimants). The schedule records whether each lender was a net receiver or net payer of funds on 7 October, or whether the effect on it was neutral (that is, that it paid out and received identical amounts in its capacities as an A and B lender).
73. Of the 46 lenders, the effect on 18 was neutral. This was because they held their A and B commitments in the same proportions as originally issued under the facility letter: as I explained

earlier, a lender with, say, a 5% A commitment would also have a 5% B commitment. Such a lender would therefore pay (as an A lender) and receive (as a B lender) the same percentage of the A levy necessary to enable the B lenders to be repaid. Although, therefore, a total of Euro 346.75m needed to be raised from A lenders to prepay the B lenders, the effect of many A/B lenders being in this neutral position was that the true extent to which the B lenders benefited by a transfer of risk to the A lenders was in the relatively small amount of Euro 68,656,810.15. Of the 18, 14 consented to the modified waiver letter, three voted against it and one abstained: the last four were Citibank NA, Deutsche Bank AG, Morgan Stanley Dean Witter Bank Limited and UBS AG. In an e-mail of 12 September to Mr McPherson, Gisle Bendiksen of Morgan Stanley had observed that the reduction did not treat lenders equally, also pointing out that certain lenders only had B commitments "and will have outstanding debt repaid without having to provide tranche A funding." Eight of the 46 lenders were in this class.

74. Of the remaining 28 lenders, 14 were net receivers and 14 were net payers. Eight of the net receivers (including JPMC, a co-chairman of the CCL) held only B commitments, and the remaining six (including TD Bank) held proportionately greater B commitments than A commitments. Subject to a twist in the tale to which I shall come, TD Bank was the largest net receiver under the modified waiver letter, receiving Euro 24,979.184.80. The 14 net payers included seven lenders who held only A commitments, with the other seven holding predominantly A commitments.

75. The seven net payers who were only A lenders included Cisco Systems Finance International, which faced a net payment obligation of Euro 32,363,333.33, the largest net payment faced by any lender. Cisco consented to the modified waiver letter, a feature which. if unexplained, might be viewed as significantly unhelpful to the claimants' case. However, some late (apparently somewhat fortuitous) disclosure revealed that Cisco had a switch option entitling it to require TD Bank and Chase Manhattan Plc to take its A commitment off their hands and replace it with a B commitment, and with it the obligation to make the payment I have mentioned. Cisco exercised that option on 30 September, an action which would suggest that, despite its consent to the modified waiver letter, it did not regard the letter as favourable to itself as an A lender. The result is that TD Bank and Chase had to pick up that particular tab, so reducing TD's net receipts and converting Chase into a net payer. I think it probable that at least Mr Bingham had forgotten about Cisco's option. This group of seven lenders (those solely in A) also included Goldentree MF, Goldentree Opportunities, HZM/Z and three other funds. After Cisco, Goldentree MF faced the largest net payment, of Euro 10,457,980. None of these six lenders consented to the modified waiver letter.

76. The seven net payers who held predominantly A commitments included CIBC World Markets plc (who paid out Euro 3,152,272.73), Credit Suisse First Boston (Euro 1,996,439.37) Goldman Sachs Credit Partners (Euro 1,277,431.17), and K Capital Offshore Master Fund LP (Euro 551,197.20), all of whom consented to the modified waiver letter. The other three did not consent.

77. The overall position with regard to those holding either only A commitments, or else holding predominantly A commitments (but leaving Cisco out of account, since I regard it as a special case) is that a substantial majority in value of the A net payers did not consent to the modified waiver letter, although a minority (four in number) did consent to it.

The claimants' complaints

78. The modified waiver letter was entered into at a time when the capital restructuring of UPCNV was, as it still is, in a state of uncertainty. It was not known then, is not known now and will not be known for some time whether the restructuring will be achieved. If it is achieved, the

waiver effected by the modified waiver letter will become permanent. If it is not, there will or may be a question mark over the future viability of the UPCNV group, including the UPCD sub-group. It was, common ground in the evidence that if the proposed restructuring of UPCNV is not achieved, that will carry with it the risk that UPCD group may fail and be unable to pay its debts. To the question why, in these circumstances, did the CCL negotiate the prepayment - requiring a drawdown on A - before it could be seen whether the restructuring was going to succeed or failed, the essence of Mr Bingham's answer was that the lenders were pressing for it (together with their other "Asks'), and the CCL took the view that it should obtain it for them immediately.

79. The claimants assert that against that background of admitted risk about UPCD's longer term viability, the modified waiver letter was manifestly unfair to the A lenders as a class, or at any rate to that minority of lenders who, like the claimants, held only A commitments, or else held predominantly A commitments. Because of UPCNV's cross-default, the A lenders had been absolved from any obligation to advance any funds to UPCD. The claimants recognise that it was open to the majority lenders to waive the default, and so render the A lenders liable to honour their lending commitments; and the claimants had even been paid a premium to take these commitments on. But whilst it is, or may be, one thing for the terms of a waiver to require the A lenders to advance funds for the working capital purposes of the UPCD group, it is, so it is said, quite another to require them to advance funds to UPCD in its present distressed state for the purpose of prepaying the B loans in respect of which no repayments are due until 2004. The effect of this aspect of the modified waiver letter was pro tanto to transfer to the A lenders the exposure, and with it the risk, which had hitherto been faced by the B lenders. To the extent that the exchange of B liability for A liability was of either neutral or cash positive effect as regards any particular lender, the modified waiver letter imposed no adverse change on that lender. But as regards that sub-class of A lenders of which the claimants are part, and which became net payers under the modified waiver letter, it required them to take over from the B lenders a real and measurable exposure at a time when UPCD's future solvency was in question. Mr Brisby submits that there is no good reason why, even if it were otherwise appropriate to reduce the facility in the manner provided for by the modified waiver letter, such reduction could not have been made conditional on the successful completion of the restructuring (although that is not a point his clients made prior to the modified waiver letter). He also points out that UPCD itself was only prepared to agree to procure the injection of the further Euro 125m of outside money into UPCD when and if the restructuring was successfully completed. Why, therefore, should the A lenders be compelled to commit their funds to UPCD in advance of that contingency? Moreover, Mr Brisby submitted that the reduction imposed by the modified waiver letter was manifestly discriminatory towards the A lenders, because it was disproportionate: it reduced the A commitment by 11.07%, whereas the B commitment was reduced by 15.16%. Mr Bingham's response to that in his evidence in chief was that these reductions Mo not appear to unduly favour Facility B Lenders over Facility A Lenders," which appears to recognise that the reductions do favour the former, but only to a due extent. Mr Bingham. adds though, as is clear from the evidence, that the CCL left to UPCD the method by which the reduction was to be achieved. Even after the claimants started complaining about the split, Mr Bingham and the CCL effectively ignored the position of the minority A lenders, apparently in part on the basis that their objections could not prevent the majority lenders having their way, but I have also set out his concern about reopening the matter at that point in the negotiations which I regard as the main reason for not doing so. In addition, Mr Brisby made the point in his reply that even if there had simply been an unconditional waiver, the covenants to which UPCD was currently subject prevented it from drawing down more than Euro 67m in

2002. He pointed out that the only basis on which it was enabled to draw down sufficient A funds to repay the B lenders was. by the cancellation (in pursuance of the majority lenders' amendment powers) in the modified waiver letter of the provisions of clauses 4.3(a)(ii) and (b) of the facility agreement. I do not, however, understand-that to have been a point made by the claimants or Cadwalader prior to the execution of the modified waiver letter.
80. These are the claimants' main points, although Mr Brisby also submits that there was an additional element of unfairness in the further risk to which the modified waiver letter exposed the A lenders, that is the risk of the further draw down of the Euro 100m for working capital, a risk which was increased by the relaxation of the covenants enabling it to be drawn; and. related to this, he points to the yet further risk to which they are exposed, namely that if the UPCNV restructuring is successfully completed, it will be open to UPCD to draw on A to the full extent of its reduced amount.

The issues
81. The claimants' main point of complaint, therefore, is that the modified waiver letter discriminated against the A lenders as a class by imposing discriminatory disproportionate overall reductions in A and B, and, at a time when the future viability of UPCD was in question, subjected the A lenders as a class - or at least that minority sub-class of A lenders of which the claimants form part - to an unfair exposure to risk solely for the purpose of removing an equivalent risk from the B lenders.
82. Mr Brisby submitted that the majority lenders were not entitled to do that. He invokes the principle summarised in the judgment of Viscount Haldane in British America Nickel Corporation, Limited, and Others v. M.J. O'Brien, Limited [1927] AC 369. Viscount Haldane said, at p. 371:
"To give a power to modify the terms on which debentures in a company are secured is not uncommon in practice. The business interests of the company may render such a power expedient, even in the interests of the class of debenture holders as a whole. The provision is usually made in the form of a power, conferred by the instrument constituting the debenture security, upon the majority of the class of holders. It often enables them to modify, by resolution properly passed, the security itself. The provision of such a power to the majority bears some analogy to such a power as that conferred by s.13 of the English Companies Act of 1908, which enables a majority of the shareholders by special resolution to alter the articles of association. There is, however, a restriction of such powers, when conferred on a majority of a special class in order to enable that majority to bind a minority. They must be exercised subject to a general principle, which is applicable to all authorities conferred on majorities of classes enabling them to bind minorities; namely, that the power given must be exercised for the purpose of benefiting the class as a whole, and not merely individual members only. Subject to this, the power may be unrestricted."
83. That principle has found similar expression in many authorities, both before and after the British America case, and Mr Brisby relied in particular on its restatement in the decision of the Court of Appeal in Greenhalgh v. Arderne Cinemas, Ltd. and Others [1951] Ch. 286. Sir Raymond Evershed MR gave the leading judgment, with which Asquith and Jenkins L.J.J. agreed. The case concerned the validity of a resolution altering the articles of association of a company. The challenge to it was based on the proposition that the resolution was not passed bona fide and for the benefit of the company as a whole, which earlier authorities had established was the touchstone for its validity. After referring to certain of those authorities, including two decisions of the Court of Appeal, the Master of the Rolls said, at p. 291:
"Certain principles, I think, can be safely stated as emerging from those authorities. In the first

place, I think it is now plain that 'bona fide for the benefit of the company as a whole' means not two things but one thing. It means that the shareholder must proceed upon what, in his honest opinion, is for the benefit of the company as a whole. The second thing is that the phrase, 'the company as a whole', does not (at any rate in such a case as the present) mean the company as a commercial entity, distinct from its corporators: it means the corporators as a general body. That is to say, the case may be taken on an individual hypothetical member and it may be asked whether what is proposed is, in the honest opinion of those who voted in its favour, for that person's benefit.
I think that the matter can, in practice, be more accurately and precisely stated by looking at the converse and by saying that a special resolution of this kind would be liable to be impeached if the effect of it were to discriminate between the majority shareholders and the minority shareholders, so as to give to the former an advantage of which the latter were deprived. When the cases are examined in which the resolution has been successfully attacked, it is on that ground."
84. Of course, that case concerned the articles of association of a company, so that the parties interested in the matter included not just the shareholders, but also the company as a separate entity. There is no equivalent of the company in the present case, but Mr Brisby submitted, and the point was not controversial, that the principles outlined by the Master of the Rolls are equally capable of applying to the manner in which a majority of a class of lenders conducts itself in relation to matters affecting the whole class, and this is shown by the British America case.
85. In reliance on what he says is the applicable principle, Mr Brisby advanced his case on two alternative grounds. He said, first, that this is a case in which the claimants could show what he called a subjective lack of good faith by the majority lenders. Alternatively, he said they could at least show that, viewing the matter objectively, no reasonable lender could have concluded that the modified waiver letter was in the interests of lenders as a whole. He said that proof of either alternative way of putting the case was sufficient to entitle the claimants to succeed. Those alternative ways of putting a case such as the present do, I consider, find support in the authorities. This is illustrated, for example, by the Court of Appeal's decision in Shuttleworth v. Cox Brothers and Company (Maidenhead), Limited, and Others [1927] 2 KB 9, one of the decisions referred to in Greenhalgh. The case concerned the validity of the alteration of a company's articles, being one whose effect was to deprive the plaintiff of his position as a permanent director. The case was in part based on the claim that the majority was motivated by bad faith towards the plaintiff. Proof that the resolution had been promoted by reasons of vindictiveness or malice towards the plaintiff would, or at least might, have been sufficient to enable him to succeed, since it could be said that its object was to do him harm rather than the company good (see, in this context, the observations of Lord Sterndale MR in Sidebottom v. Kershaw, Leese and Company, Limited [1920] 1 Ch. 154, at 161). The judge, however, ruled against the allegations of bad faith, and the Court of Appeal upheld that finding. But the possibility of a successful challenge to the resolution viewed simply on an objective basis still remained. Bankes LJ identified, at p.18, the relevant test as being whether the alteration of the articles was in the opinion of the shareholders for the benefit of the company. He said:
"By what criterion is the Court to ascertain the opinion of the shareholders upon this question? The alteration may be so oppressive as to cast suspicion on the honesty of the persons responsible for it, or so extravagant that no reasonable men could really consider it for the benefit of the company. In such cases the Court is, I think, entitled to treat the conduct of shareholders as it does the verdict of a jury, and to say that the alteration of a company's articles shall not stand if it is such that no reasonable men could consider it for the benefit of the

company. Or, if the facts should raise the question, the Court may be able to apply another test - namely, whether or not the action of the shareholders is capable of being considered for the benefit of the company."

86. Scrutton LJ made observations to much the same effect. He said, at p. 23:

"Now when persons, honestly endeavouring to decide what will be for the benefit of the company and to act accordingly, decide upon a particular course, then, provided there are grounds on which reasonable men could come to the same decision, it does not matter whether the Court would or would not come to the same decision or a different decision. It is not the business of the Court to manage the affairs of the company. That is for the shareholders and directors. The absence of any reasonable ground for deciding that a certain course of action is conducive to the benefit of the company may be a ground for finding lack of good faith or for finding that the shareholders, with the best motives, have not considered the matters which they ought to have considered. On either of these findings their decision might be set aside."

87. I say straight away that I am unable to accept the claimants' case in so far as it based on what Mr Brisby referred to as subjective lack of good faith. That is simply a politely phrased allegation. of subjective bad faith, and appears to amount to an allegation that the majority lenders in general, and TD Bank in particular, were motivated in promoting the modified waiver letter either by (i) a wish to improve their own position at the expense of the A lenders, or (although I do not in fact understand the claimants to have suggested this) (ii) by motives of vindictiveness or malice towards the claimants and other A lenders in the like interest. There is no evidence from any of the majority lenders other than TD Bank, and I feel quite unable to conclude that any of those other lenders was motivated in its decision to consent to the modified waiver letter by any sort of considerations of bad faith towards anyone. It is not even clear to what extent any of them (apart from those on the CCL, and those who were themselves destined to be net payers) were aware that there were sub-classes of A lenders who would be net payers ' as a result of the modified waiver letter. Nor am I prepared to make any findings of bad faith against TD Bank or any other lender on the CCL. It is true that they were informed of the essence of the claimants' concerns in September, and made a decision not to raise the points with the lenders. But in doing so, I find that they were not motivated by considerations of self-interest at the expense of the A lenders, or by any injurious ill-will towards the claimants. They were instead concerned that to do so at that stage in the operation might derail the restructuring negotiations, and they anyway did not consider that the minority's objections could make any difference to the outcome of the waiver negotiations. They may or may not have been misguided in that approach, which is something I will have to consider. But I have no hesitation in concluding that it was in no manner influenced by anything that might fairly be characterised as bad faith. In my view, if the claimants are entitled to succeed in this action, it can only be on the basis that, viewed objectively, the modified waiver letter was sufficiently discriminatory and unfair towards that sub-class of A lenders to which the claimants belong to justify the finding that the letter was not for the benefit of the lenders as a whole, or cannot be regarded as being capable of being considered to be for their benefit, or was otherwise an improper exercise of the clause 25 power.

88. Assuming that Mr Brisby is correct in his general submission as to the actions of the majority lenders, that will not, however, be enough to get the claimants home. They also have to show that UPCD is similarly affected by their challenge to the modified waiver letter, since on the face of it UPCD is able to say that it has concluded a binding contractual variation with TD Bel, and that it is nothing to the point that the claimants may have complaints about the manner in which TD Bel was given its authority to sign the letter. Mr Brisby's answer is that, prior to the signing of the modified waiver letter, UPCD had been copied in on all the correspondence that

Cadwalader wrote to Allen & Overy and was expressly on notice that the claimants challenged TD Bel's authority to sign the modified waiver letter, and of course UPCD knew the terms of the modified waiver letter. On the facts, there is no dispute about that. If, therefore, the claimants can show that TD Bel had no authority to sign, UPCD signed up to the letter in the knowledge of that risk. In those circumstances, Mr Brisby submits that, if the claimants make good their case against the majority lenders, they must succeed against UPCD as well.
89. But is Mr Brisby correct that the Greenhalgh principle (as I shall call it) applies to this case? If the claimants satisfy the court that the terms of the modified waiver letter were not for the benefit of all the lenders - because they were, on the face of it, ostensibly discriminatorily disadvantageous to a small sub-class of A lenders - is that enough to entitle the claimants to succeed?
90., If I may say so, Mr Brisby conducted his clients' case with very considerable skill, and advanced an excellent argument to me. But the excellence of his argument was matched by the excellence of those I also heard from Miss Jones and Mr Onions. I confess to having found this a difficult case. But, essentially for the reasons advanced by Miss Jones and Mr Onions, I have come to the conclusion that the principle by reference to which Mr Brisby asks me to decide the case is not the correct one.
91. The starting point is that the facility agreement is a commercial contract between a large multitude of lending bankers and their borrowers. It governs not just the lenders' relationship with the borrowers, but also the relationship between the lenders themselves. The contract has been carefully and professionally drawn and clause 25 devotes itself to setting out the contractual basis on which its. terms may be varied as between the lenders and borrowers. Save for the various entrenched provisions, which require unanimous consent before they can be altered, the lenders have, by their contract, empowered a two-thirds majority in value to consent to changes in the facility agreement, being changes which are capable of affecting and binding all of them. Clause 25 also empowered the majority lenders to agree to waivers under the agreement. The modified waiver letter is the fruit of the exercise of those powers.
92. The claimants' case is that that power is subject to the general principle of law relating to the manner in which a majority can bind a minority, namely that the power must be exercised bona fide for the benefit of the lenders as a whole. If so, it can only be on the basis that a principle to that effect is an implied term of the facility agreement. On ordinary principles, terms will only be implied into contracts if, as a matter of necessity, they are required for business efficacy purposes (The Moorcock (1889) 14 P.D. 64), or if it is a matter of obvious inference that they were intended to apply to the contract (Shirlaw v. Southern Foundries (1926) Ltd. [1939] 2 KB 206, per MacKinnon LJ at 227), or if they are necessary to give effect to the reasonable expectations of the parties (Equitable Life Assurance Society v. Hyman [2002] 1 AC 408, per Lord Steyn at 458). In the present case, if the suggested term is to be regarded as implied into the facility agreement, it would appear to me that it could only be on either the second or third basis.
93. It was Miss Jones who bore the main burden of dealing with this aspect of the defendants' arguments. It is of course no part of her case that clause 25 can or should be regarded as conferring on the majority an unfettered power to act arbitrarily, capriciously or oppressively, and she fully accepts that the power is impliedly subject to certain restrictions in the manner of its exercise. But her main point is that to treat clause 25 as being subject to an implied term that the power to waive and amend can only be validly exercised in a manner which can be seen to be for the benefit of the lenders as a whole - at any rate if that phrase is interpreted as carrying the sense of the literal meaning of its language - would be likely, in readily foreseeable circumstances, wholly to paralyse the exercise of the power. Miss Jones submits that this

cannot have been the intention of the parties to the facility agreement, and submits that no term having the potential to cause such an effect can be implied into it.
94. The reason for that is because the lenders under the facility agreement cannot simply be regarded as one unified class of lenders, all with a like interest. They are split into three classes, A, B and C, and the rights and interests of each class are peculiar to that class. I have set out how the different commitments were taken up by the original lenders when the facility agreement was entered into. But of course the agreement itself provided for those interests to change hands, and it was foreseeable at the time of the agreement that, as has happened, the original pattern of holdings would change. Miss Jones points out that it was similarly foreseeable at the time of the signing of the facility agreement that circumstances could arise in the future in which the commercial interests of one class might differ from those of another class. In such a situation, it would or could be almost inevitable that any decision by the majority in value of the lenders would or could be viewed as favouring one class over another. Put another way, it would or could in practice often be impossible for the majority to exercise their clause 25 powers in a manner which, viewed objectively, could be said to be for the benefit of each hypothetical member of each class.
95. The circumstances giving rise to the present action provide a good working example of the type of problems that could always be foreseen as capable of arising, but I consider that the point can be better illustrated by changing the facts a little. Assume that by February 2002 (i) the A commitments had been so dealt with on the secondary market that most of them were held by lenders with no B or C commitments, (ii) that the A commitments were wholly undrawn and the B and C commitments were fully drawn, and (iii) that UPCD then committed a default. At that point, it is quite likely that there would or might be a stark divergence of interest between the A lenders on the one hand and the B and C lenders on the other. The latter may conclude that the state of the economy is such that to realise their security at that point will result in enormous losses, and that the best prospect of being able to recover all or most of their debt will be to take a long term view, in the hope that the company can trade through its difficulties. For this purpose, they will wish to waive the default and enable the company to draw on the A lenders for the cash it will need to continue trading. But for the A lenders, who on my assumed facts comprise a class of lenders most of whom have no other lending commitments under the facility agreement, the picture is rather different. They have advanced no money to the company; the default has excused them from making any advances; and it is probable that they would prefer that there should be no waiver at all, so that they could instead advance their money to another institution more creditworthy than a company in the state of distress into which the borrower company had fallen. The situation would thus be one in which it could well be said that it would be for the positive benefit of the B and C lenders for there to be a waiver, but that a waiver would be to the positive detriment of the A lenders. If the claimants' argument in this case is right, then it would not be open to the majority lenders to waive the default, since the A lenders could say that it would not be for the benefit of the lenders as a whole. So, in practice, the A lenders could veto it. They could paralyse the powers of the majority lenders at the just the type of crisis point in the lending transaction at which it might be thought that the facility agreement intended the majority lenders to be able to act.
96. I did not understand Mr Brisby to dispute that it was inherent in the scheme of the facility agreement that conflicts of this or a like sort could arise in the respective interests of the three classes of lenders. As I understood it, however, his position is that that possibility had and. has no relevant impact on his proposition that the Greenhalgh principle is impliedly incorporated into provisions of clause 25 of the agreement. His submission was that, if it should prove impossible for the majority to be able to exercise their powers in a non-discriminatory way, then the

exercise of their powers would or might be paralysed, and that the only way forward would or might be to attempt to achieve the unanimous consent of the lenders to whatever was being proposed (which, ex hypothesi, is likely to be a vain attempt), or else to seek to achieve a scheme of arrangement between the borrowers and the lenders. In short, his point is that the clause 25.1 powers are only exercisable if they can be exercised in a manner consistent with the Greenhalgh principle. If they cannot, then they cannot be exercised at all.
97. I feel unable to accept that proposition quite in the terms in which it was put, which would appear to me to attribute to the parties to the facility agreement some improbable intentions. The main, although not the only, function of clause 25 is to establish a mechanism for dealing with problems of the varying types which might arise in the course of a facility agreement destined to have a nine-year life. When there are three different classes of lenders, the likelihood of differences arising between their respective interests is considerable. I have equally no doubt that it was the intention of the parties to the facility agreement that the requisite majority of the lenders - being a two thirds majority of all lenders, there being no provision for separate class meetings - should have the capacity to make decisions binding on all lenders. Moreover, often those decisions would have to be made in fairly short order, and it will be noted that clause 25 contains no machinery for consultation, discussion, representations or voting, although in practice (as happened in the present case) some sort of de facto mechanism would have to be set up by the lenders so that they could ascertain what the majority's views are. Mr Brisby's proposition that clause 25 is subject to an implied proviso which can operate to switch off its mechanism at the very time when it is probably most needed to be engaged is one I do not regard as well founded.
98. Having regard to the particular terms of the facility agreement, my view so far is therefore that clause 25 was and is intended to enable the majority lenders to make decisions binding on all three classes, even though it might perhaps be capable of being said by one class that the decision could not be said to be for its benefit. In the example I have earlier given, I can in particular see no reason why (if the facts showed it was a proper and responsible decision) the majority lenders should not agree to waive the default so as to enable the company to trade on and, in doing so, to draw on the A facility. Nor can I see any good reason why, in principle, the majority lenders should not be able to agree that the financial covenants should be relaxed if that were necessary to enable the borrowers to draw down sufficient of the A funds as they needed for the purposes of their continued trading. The A lenders might well regard that as either actually, or potentially, prejudicial to them, and might, were the choice left to them, want no part of it; whereas the B and C lenders would regard it as the most beneficial way forward as far their own interests were concerned. But, in principle (and it will always depend on the facts), I can see nothing necessarily unfair towards the A lenders in a decision that the default should be waived and the covenants relaxed. The point is that the facility agreement is one under which all three lending classes are part of the long term lending package, and no class is entitled to say that it has had enough and wants to call a halt to its commitments. By signing up at the outset, each lender submits to the decision of the majority lenders at important forks in the road. The decision of the majority to allow the company to trade would, in my view, be exactly the type ' of decision that clause 25 was directed at enabling the majority lenders to make.
99. I was referred to a number of authorities on majority control, although none was of direct assistance for the purposes of the resolution of the present case. Most concern cases in which the persons affected by the relevant resolution were members of a single class, all with (in theory) like interests. The present case is different, because of the existence of the three classes with potentially differing interests. One authority which I did regard as of assistance in

casting light on the correct approach to this case is the decision of the High Court of Australia in Peters' American Delicacy Company Limited v. Heath and Others (1938-39) 61 CLR 457. The problem there arose out of the company's somewhat ill-drawn articles of association. Articles 108 to 111 provided for cash dividends to be paid to members in proportion to the capital paid up on their respective shares. Article 120 provided that "Notwithstanding anything in any other article contained" profits could, with the authority of the company in general meeting, be distributed in the form of fully or partly paid shares in proportion to the number of shares held by the respective members. What gave rise to the dispute was a special resolution altering article 120 so that, on a capitalisation of profits, the distribution should be in accordance with the amount paid up on the respective shares of the members participating. The resolution was passed, but those with partly paid shares complained that it was unfairly favourable to the holders of fully paid shares. They complained that the resolution was not for the benefit of the company (meaning the corporators) as a whole, because they were prejudiced by it.

100. Nicholas J, sitting in the Supreme Court of New South Wales, upheld the complaints. The judgments of the High Court reversing his decision occupy some 40 pages, and were given by Latham CJ, Rich J and Dixon J, with McTiernan J agreeing. They include a careful examination of the English authorities touching on the "benefit of the company as a whole" point and provide an illuminating insight into the principles.

101. The value of the decision is that it arose out of a background in which the existing articles gave rise to a conflict of interest between different groups of shareholders, and the purpose of the alteration was to resolve that conflict. Inevitably, the alteration could not please everyone, and the challenged resolution could not be defended on the basis that it could be said to have been for the benefit of the company - or the corporators - as a whole. There was, however, no suggestion of fraud or bad faith by anyone, and nor was there any evidence that the alteration was made with the object of oppressing a minority or depriving it of its rights (see the judgment of Rich J, at 490). At p. 495, after referring to various English authorities (including the Sidebottom and Shuttleworth cases, which I also referred to earlier), Rich J said:

"Where the very problem which arises contains as inherent in itself all the elements of a conflict of interests between classes of shareholders these authorities do not mean that the power of alteration is paralysed, they mean only that the purpose of bringing forward the resolution must not be simply the enrichment of the majority at the expense of the majority. The resolution in the present case was brought forward to solve a difficulty and make possible a capitalization. It can hardly be supposed that, the only solution of such a difficulty which can be lawfully adopted is that which gives the minority an advantage at the expense of the majority. In my opinion the case presents nothing but an ordinary example of an honest attempt on the part of the directors to clear up a difficulty by securing an alteration of the articles not unjust to any class of shareholders, but at the same time conserving the interests of the shareholders who form the great majority of the company."

102. I regard Dixon J's judgment as a particularly valuable one. He observed, at p. 503, that 'It, is one thing, however, to say that [the power to alter articles] is not unlimited or uncontrolled and another to define the grounds upon which an ostensible exercise of the power should be considered invalid." He then devoted considerable care to extracting from the authorities how those latter grounds can best be identified, observing en route, at p. 507, that:

"whatever may constitute bad faith, it is evident that, if a resolution is regularly passed with a single aim of advancing the interests of a company considered as a corporate whole, it must fall within the scope of the statutory power to alter articles and could never be condemned as mala fides. A positive test was therefore available, conformity with which necessarily spelt validity."

103. He then referred to the decision of the Court of Appeal in Allen v. Gold Reefs of West

Africa Ltd. [1900] 1 Ch 656, and identified it as the source of the view, which can be found reflected in later authorities, that the validity or invalidity of the exercise of the power depended absolutely on whether that positive test had been satisfied, namely whether "the power had been exercised bona fide for the benefit of the company as a whole" and that nothing less would do. Dixon J appears to have regarded that as involving a wrong turn or emphasis. He referred to certain later decisions, including Brown v. British Abrasive Steel Co. Ltd. [1919] 1 Ch. 290, the Sidebottom case, Dafen Tinplate Co. Ltd. v. Llanelly Steel Co. (1907) Ltd. [1920]2 Ch. 124, and the Shuttleworth case. He then said this, at pp.511 to 513:
"If no restraint were laid upon the power of altering articles of association, it would be possible for a shareholder controlling the necessary voting power so to mould the regulations of a company that its operations would be conducted or its property used so that he would profit either in some other capacity than that of a member of the company or, if as a member, in a special and peculiar way inconsistent with conceptions of honesty so widely held of professed that departure from them is described, without further analysis, as fraud. For example, it I would be possible to adopt articles requiring that the company should supply him with goods below cost or pay him ninety-nine per cent of its profits for some real or imaginary services or submit to his own determination the question whether he was liable to account to the company for secret profits as a director.
The chief reason for denying an unlimited effect to widely expressed powers such as that of altering a company's articles is the fear or knowledge that an apparently regular exercise of the power may in truth be but a means of securing some personal or particular gain, whether pecuniary or otherwise, which does not fairly arise out of the subjects dealt with by the power and is outside and even inconsistent with the contemplated objects of the power. It is to exclude the purpose of securing such ulterior special and particular advantages that Lord Lindley [in the Allen case] used the phrase 'bona fide for the benefit of the company as a whole.' The reference to 'benefit as a whole' is but a very general expression negativing purposes foreign to the company's operations, affairs and organizations. But unfortunately, as appears from the foregoing discussion, the use of the phrase has tended to cause misapprehension. If the challenged alteration relates to an article which does or may affect an individual, as, for instance, a director appointed for life or a shareholder whom it is desired to expropriate, or to an article affecting the mutual rights and liabilities inter se of shareholders or different classes or descriptions of shareholders, the very subject matter involves a conflict of interests and advantages. To say that the shareholders forming the majority must consider the advantage of the company as a whole in relation to such a question seems inappropriate, if not meaningless, and at all events starts an impossible inquiry. The 'company as a whole' is a corporate entity consisting of all the shareholders. If the proposal put forward is for a revision of any of the articles regulating the rights inter se of shareholders or classes of shareholders, the primary question must be how conflicting interests are to be adjusted, and the adjustment is left by law to the determination of those whose interests conflict, subject, however, to the condition that the existing provision can be altered only by a three-fourths majority. Whether the matter be voting rights, the basis of distributing profits, the basis of dividing surplus assets on a winding up, preferential rights in relation to profits or to surplus assets, or any other question affecting mutual interests, it is apparent that though the subject matter is among the most conspicuous of those governed by articles and therefore of those to which the statutory power is directed, yet it involves little if anything more than the redetermination of the rights and interests of those to whom the power is committed. No-one supposes that in voting each shareholder is to assume an inhuman altruism and consider only the intangible notion of the benefit of the vague abstraction called by Lord Robertson in Baily's Case [1906] AC 35, at p.39, 'the company as an

institution.' An investigation of the thoughts and motives of each shareholder voting with the majority would be an impossible proceeding. When the purpose of a resolution is spoken of, a phrase is used which refers rather to some characteristic implicit in the resolution in virtue of the circumstance or of some larger transaction of which it formed a part or step. It is not far removed from what Lord Sumner called 'one of those so-called intentions which the law imputes ... the legal construction put on something done in fact' (Inland Revenue Commissioners v. Blott [1921] 2 AC 171, at p. 218). But, when the very question to be determined is a conflict of interests, unless the subject matter is held outside the power, the purpose of the resolution, as distinguished from the motives of the individuals, often must be to resolve the conflict in favour of one and against the other interest.
In my opinion it was within the scope and purpose of the power of alteration for a three-fourths majority to decide the basis of distributing shares issued for the purpose of capitalizing accumulated profits or profits arising from the sale of goodwill, and in voting for the resolution shareholders were not bound to disregard their own interests. ... the resolution involved no oppression, no appropriation of an unjust or reprehensible nature and did not imply any purpose outside the scope of the power." (My emphasis in the second paragraph)
104. I regard Dixon J's judgment as a helpful guide as to how I should assess the attack levelled at the modified waiver letter by the claimants, and his emphasised observations were later echoed in Howard Smith Ltd. v. Ampol Petroleum Ltd. and Others [1974] AC 821, in which Lord Wilberforce said, at 835, after referring to the phrases "bona fide in the interest of the company as a whole" and "for some corporate purpose" that:
"Such phrases, if they do anything more than restate the general principle applicable to fiduciary powers, at best serve, negatively, to exclude from the area of validity cases where the directors are acting sectionally, or partially, ie improperly favouring one section of the shareholders against another. Of such cases it has been said:
"The question which arises is sometimes not a question of the interest of the company at all, but a question of what is fair as between different classes of shareholders. Where such a case arises some other test than that of the 'interests of the company' must be applied, ..."(Mills v. Mills, 60 CLR 150,164, per Latham CJ)."
105. I derive from these two authorities that, at least in a case such as the present, where there is a clear potential for conflicting interests between the three classes of lenders, an assessment of the validity of a majority decision exclusively by reference to whether or not it is "for the benefit of the lenders as a whole" is, at any rate if those words are applied according to their literal meaning, a misplaced one. The vice against which control on the exercise of majority power is directed is the potential for a dishonest abuse of that power. The starting point in assessing the validity of its exercise in any case must be to assess, by reference to all available evidence, whether the power is being exercised in good faith for the purpose for which it was conferred. If it is, then the mere fact that it can be shown that a minority of those affected by it have been relatively disadvantaged by it as compared with the majority cannot automatically mean it has been exercised improperly. Of course, if it can be shown that the power has been exercised for the purpose of conferring special collateral benefits on the majority, or if the obtaining of such collateral benefits can be shown to have been the motive for the exercise of the power, that will be likely to lead to a conclusion that the exercise has been bad. It would not have been exercised for the purpose for which it was conferred, and its exercise in those circumstances would or might amount to a fraud on the minority. Equally, if the exercise of the power can be shown to have been motivated by a malicious wish to damage or oppress the interests of the minority adversely affected by it, then that too will vitiate the exercise, since that too will clearly amount to the commission of fraud on the minority, which is also obviously

outside the scope and purpose of the power. Proof of matters of this sort may of course be difficult, and in many cases the complainants may have no independent evidence enabling them to level attacks on the exercise of the power on grounds such as these. They may, and usually will, be able to do no more than point to the manner of the exercise of the power and invite the inference that it is so manifestly disadvantageous, discriminatory or oppressive towards them that the only conclusion that can be drawn is that it must have been motivated by dishonest considerations inconsistent with a proper exercise of the power for the purpose for which it was intended. If the facts are strong enough, the court may well be prepared to draw such a conclusion.

106. I therefore reject any suggestion that, to succeed in this case, the claimants need only to show that the modified waiver letter can be said ostensibly to have discriminated against them and cannot, therefore, be said to be for the benefit of the lenders as a whole. I should, however, record that Mr Onions submitted that, on the facts, the package it contained both could and should be regarded as being of benefit to all lenders - or at least as being capable of being considered as being of such a benefit (see the citation in paragraph 85 above from Bankes Us judgment in the Shuttleworth case for the explanation of the latter submission). He emphasised that the package included identifiable benefits for all classes of lenders. The reduction of the overall facility (in which the A lenders share: the reduction they enjoy is in fact of the same order that they were due to enjoy in 2005, but it has now been accelerated by three years) was a positive benefit to all lenders, resulting in the lenders enjoying proportionately increased security for an overall reduced liability. In addition, waiver fees are to be paid and the interest rates were increased. The claimants share in all these things, and Mr Onions said that all they are really complaining about is having to do what they were paid to do when they acquired their A paper on the market, namely to honour their commitment to lend. But, having so acquired their A commitments, their status under the facility agreement is as a lender, and the package offers them, if not the certainty, at least the prospect of benefit from its terms. In addition, its terms have improved UPCD's repayment profile, and so in turn have improved the lenders' (including the A lenders') prospects of ultimately being repaid in full. In these circumstances, Mr Onions submits that the claimants have failed to show that the modified waiver letter was incapable of being for the benefit of the lenders as a whole - and the burden of proof is on the claimants to show that the majority lenders' exercise of the clause 25 power was bad.

107. I have noted these points, which I regard as having force, but I am prepared to assume in the claimants' favour that they are right that, at least viewed objectively, the modified waiver letter cannot be said to have conferred a like benefit on all lenders, and that it can be regarded as having ostensibly discriminated against that small sub-class of A lenders who became net payers. In some cases, the demonstration of such discrimination might justify an inference that the exercise of the power had been motivated by improper considerations that ought to vitiate it. But every case turns on its facts, and I am unable to accept that any such inference is justified in this one.

108. The key point in this case is that the claimants' complaints seem to be founded on the premise that the majority lenders had a free hand as to the terms of the modified waiver letter; that they could and should have recognised the disadvantages to which it subjected a small sub-class of A lenders; and they should have somehow (precisely how is not identified) devised a different scheme which treated everyone equally. The fallacy in this is that the majority lenders did not hold all the cards and did not have such a free hand. The modified waiver letter represented the fruit of an arm's length negotiation between TD Bank and UPCD. I find that those negotiations were not easy, and UPCD was not prepared to give the lenders precisely what they wanted. TD Bank could not simply dictate the terms: UPCD could have called the

lenders' bluff and invited them to realise their securities. One thing the lenders did want was an. overall reduction in the facility, and assumed it would be in its undrawn elements. In the first instance, UPCD would not agree to any reduction, and required that any discussions on the subject had to be with UGC. Although UGC then agreed to a Euro 500m reduction, it also insisted that UPCD should decide how it should be allocated. This was an understandable condition, since UPCD had to be able to satisfy itself how it could accommodate a Euro 500m reduction within its cash requirements. UPCD did decide on the method of allocation, and the result was the scheme contained in the modified waiver letter, being an allocation between two of the three facilities, which it regarded as the optimal one for its own cash flow purposes.
109. Now it would seem to me that, in this particular context, the optimal allocation from UPCD's viewpoint was likely also to be the optimal allocation from the lenders' viewpoint. The allocation worked out by UPCD was that which gave it the best chance of survival, and Mr Brisby's stance in his cross-examination of Mr Okhuijsen was that it was the only allocation to which it could agree. Mr Okhuijsen. did not regard the matter quite so inflexibly, and indicated that, had the C lenders insisted on a share of the reduction, he could have accommodated them, but that is not what he wanted, and in the event the C lenders did not ask for a share.
110. The result, therefore, was that what was put to the lenders on 4 September was an allocation on which UPCD was insisting. It had not been pre-determined by TD Bank, the CCL or any of the lenders, and any suggestion that the lenders or any of them in some manner fixed it so that the B lenders could benefit at the expense of the A lenders is unfounded (in fact, only 14 out of the 29 B lenders so benefited: on others the effect was either neutral, or else they were net payers). The claimants' complaint, as repeatedly expressed in the oral evidence of Mr Wilkinson, their solicitor (none of the individuals behind any of the claimants gave evidence) was that the allocation involved the making by the A lenders of advances to pay B lenders. The allocation did involve that, and it can be said to have had an ostensible adverse effect on that small minority of A lenders which became net payers. But that adverse effect was simply part of the price of achieving the overall facility reduction which was for the benefit of all lenders, including the A lenders. The existence of such an effect does not, in my view, automatically undermine the fairness of the reduction scheme as a whole, nor does it cause it fall outside the purpose of the clause 25 power. Nor, in my view, does the exercise of the power become bad because it was necessary, in order to implement the proposed reduction, for the majority lenders also to amend the covenants so as to enable UPCD to make the required draw down. That was simply part of the mechanics necessary to achieve the reduction.
111. Two further points need to be made about the allocation as between the A and B lenders. First, complaint is made that the A facility was reduced by only 11.07% whereas the B facility was reduced by 15.16%. That is said to be manifestly discriminatory and unfair. In my view, this point is not well founded. The explanation for the difference is that it was a necessary consequence of UPCD calculation of the optimal allocation. It was not being imposed on the A lenders by the majority lenders, it was in effect being imposed on all the lenders by UPCD. Equality across the board was not the exercise that UPCD was trying to achieve; it was trying to achieve the optimal method of effecting the overall reduction, being a reduction which would benefit all lenders. In particular, the C lenders were given no reduction at all, but they raised no objections and a majority of them consented to the modified waiver letter. The short explanation for the disparity between the A and B lenders in this respect is that UPCD was calling the tune on this aspect of the waiver,, and whilst (for its own good commercial reasons) it was prepared to agree to unequal reductions as between the three lending classes, it was not prepared to agree to equal reductions. It is possible that, had the CCL gone back to UPCD, it might have been able to persuade it to agree a different allocation, although this would not have been as

beneficial to UPCD - and it was important that UPCD had a repayment profile which it could meet. The agreement of the majority lenders to this particular disparity as part of the means of achieving the overall reduction was, in my view, a commercial decision to which they were perfectly entitled to come, and it was one which I consider was within the scope of the power conferred on them by clause 25. Mr Brisby's submission that this disparity was, by itself, manifest discrimination entitling the claimants to succeed is one which I am unable to accept. It can only be advanced on the basis that clause 25 requires the waiver and amendment powers to be exercised equally across the board as between all three classes of lenders. In my judgment, that approach to clause 25 involves subjecting it to restrictions which it cannot fairly bear.

We have been considering the relationship between contracts and trot and fiduciary duty. The Delaware Chancery Court addressed this issue in a recent case, *Abry Partners V, LP v F&W Acquisition LLC*.[11] The contract (a stock purchase agreement) limited liability in relation to representations in the contract (the contract established an indemnity fund and limited liability to the amount of the fund). The purchaser alleged the existence of a scheme to manipulate the financial statements of the acquired entity to increase the purchase price. Vice Chancellor Strine declined to enforce the contract as written:

For reasons I explain, I conclude that Delaware law permits sophisticated commercial parties to craft contracts that insulate a seller from a rescission claim for a contractual false statement of fact that was not intentionally made. In other words, parties may allocate the risk of factual error freely as to any error where the speaking party did not consciously convey an untruth. In that context, there is no moral imperative to impinge on the ability of rational parties dealing at arms-length to shape their own arrangements, and courts are ill-suited to set a uniform rule that is more efficient than the specific outcomes negotiated by particular contracting parties to deal with the myriad situations they face.
But the contractual freedom to immunize a seller from liability for a false contractual statement of fact ends there. The public policy against fraud is a strong and venerable one that is largely founded on the societal consensus that lying is wrong. Not only that, it is difficult to identify an economically-sound rationale for permitting a seller to deny the remedy of rescission to a buyer when the seller is proven to have induced the contract’s formation or closing by lying about a contractually-represented fact.
For these reasons, when a seller intentionally misrepresents a fact embodied in a contract — that is, when a seller lies — public policy will not permit a contractual provision to limit the remedy of the buyer to a capped damage claim. Rather, the buyer is free to press a claim for rescission or for full compensatory damages. By this balance, I attempt to give fair and efficient recognition to the competing public policies served by contractual freedom and by the law of fraud.

Why is fraud an exception?

The Vice Chancellor also made some comments about the impact of contracting on

[11] http://courts.delaware.gov/opinions/(xjdlbg2orlgze345sjcd0quc)/download.aspx?ID=72140

liability in tort which are relevant to the Armco case:

Parties operating in interstate and international commerce seek, by a choice of law provision, certainty as to the rules that govern their relationship. To hold that their choice is only effective as to the determination of contract claims, but not as to tort claims seeking to rescind the contract on grounds of misrepresentation, would create uncertainty of precisely the kind that the parties' choice of law provision sought to avoid. In this regard, it is also notable that the relationship between contract and tort law regarding the avoidance of contracts on grounds of misrepresentation is an exceedingly complex and unwieldy one, even within the law of single jurisdictions. To layer the tort law of one state on the contract law of another state compounds that complexity and makes the outcome of disputes less predictable, the type of eventuality that a sound commercial law should not seek to promote.

ASSIGNMENTS, NOVATIONS, SALE OF PARTICIPATIONS

If a lender (L) assigns its interest under a loan agreement to another entity (T) it transfers its rights under the agreement but not its obligations. In contrast novation substitutes the transferee for the lender so that the transferee takes on the lender's rights and obligations under the loan agreement. A lender could also grant sub-participations to other entities.

We saw when we focuused on Elliott Associates that sometimes assignments are challenged on the basis that the assignment breached terms of the original agreement. Another case where such arguments were raised is *Essar Steel v The Argo Fund*, a recent decision of the English Court of Appeal.[12] This excerpt is from Lord Justice Auld's judgment:

1 This is an appeal by Essar Steel Ltd ("Essar") against a decision of Mr Justice Aikens on 12th April 2005 concerning the meaning and effect of a provision in an unsecured syndicated loan agreement (the "Agreement") made on 7th March 1997 between Essar as borrower and a syndicate of nine banks and financial institutions (the "Syndicate"), restricting the Syndicate members' entitlement to transfer their rights and obligations under the Agreement to entities that are "a bank or other financial institution". The case concerns the purported transfer by some of the Syndicate members to the Respondent, The Argo Fund Limited ("Argo"), in 2002 and 2003 in the "secondary debt market" of part of the over-all loan drawn down by Essar.
2 The Agreement is the standard 1997 Loan Market Association ("LMA") form, which, at the material time, contained no further definition or elaboration of the term "bank or other financial institution". In November 2001 the LMA revised the definition by adding to it "trust, fund or other entity which is regularly engaged in or established for the purpose of making, purchasing or investing in loans, securities or other financial assets". It did so in order to remove grounds for dispute, illustrated by this appeal, as to the range of entities that could qualify as a "financial institution" within this provision. However, there are apparently many syndicated loan agreements, in addition to this one, in the 1997 LMA un-amended form that are or may be the occasion of similar dispute as to the range of institutions to which syndicate members may

[12] http://www.bailii.org/ew/cases/EWCA/Civ/2006/241.html

transfer debts in the secondary debt market.
3 The agreed expert evidence before the Judge indicated that restrictions on transferability in such agreements were not uncommon in 1997 when this Agreement was made and that there were a number of reasons why potential parties to such agreements might wish some such restriction. These included the preservation of a continuing relationship between borrower and lenders and between the lenders themselves; minimisation of costs of administration of the loan and to retain replacement lenders who would be likely to observe the law and regulatory guidelines. The question for the Court is whether and to what extent the restriction in this case, in its unadorned 1997 form, was intended by Essar and the Syndicate members to serve such or other purposes and, more particularly, whether it served to exclude Argo from claiming repayment as a transferee under the Agreement...
5 Argo is an investment company incorporated in 2000 in the Cayman Islands, which, as part of a small group of companies, holds and manages funds and the investments purchased with them. At all material times, it had a portfolio of debt, including bonds, loans, letters of credit and promissory notes, mainly purchased in the secondary debt market from other institutions. Argo described itself as a "Global Emerging Markets Debt Hedge Fund", and had as its investment aim the securing of higher returns for investors at the more risky end of the market, though it had sometimes acted as an original lender. ...
18 Clause 27 of the Agreement provided for two modes by which Syndicate members could pass their rights under the Agreement to another, one by way of assignment on notice to Essar, the other by way of transfer, which also operated to transfer obligations as well as rights, amounting to a novation. As to assignment, the Agreement imposed no restriction save as to documentation and notice to Essar, clause 33.1 expressly providing that, where the context permitted, "any 'Bank'" should be construed so as to include "without limitation … Transferees and assigns in accordance with their respective interests". As to transfer, the context did not permit such limitless construction, since clause 1, the interpretation clause, defined a "Transferee" as:

"a bank or other financial institution to which [a Syndicate member] seeks to transfer all or part of such [member's] rights and obligations hereunder in accordance with the provisions of this Agreement." [my emphasis]
19 Clause 27 provided, so far as material:
"27.1 This Agreement shall be binding upon, and inure to the benefit of each party hereto and their respective successors, Transferees and assignees. … Any Bank may, subject to the execution and completion of such documents as the [Syndicate members'] Agent may specify and with notice to the Borrower, assign all or any of its rights and benefits hereunder or, subject to the payment to the Agent of a transfer fee of $250, transfer in accordance with Clause 27.2 all or any of its rights, benefits and obligations hereunder.
27.2 If any Bank wishes to transfer all or any of its rights, benefits and/or obligations hereunder, then such transfer may be effected by the delivery to the Agent of a duly completed and duly executed Transfer Certificate in which event …:
(i) to the extent that in such Transfer Certificate the Bank party thereto seeks to transfer its rights and obligations hereunder, the Borrower and such Bank shall be released from further obligations towards one another hereunder and their respective rights against one another shall be cancelled (such rights and obligations being referred to in this Clause 27.2 as 'discharged rights and obligations');
(ii) the Borrower and the Transferee party thereto shall assume obligations towards one another and/or acquire rights against one another which differ from the discharged rights and

obligations only insofar as the Borrower and the Transferee have assumed and/or acquired the same in place of the Borrower and such Bank; and

(iii) … the Transferee and the other Banks shall acquire the same rights and assume the same obligations between themselves as they would have acquired and assumed had the Transferee been an original party hereto as a Bank with the rights and/or obligations acquired or assumed by it as a result of such transfer"...

27 Mr Laurence Rabinowitz QC, on behalf of Essar, maintained that the Judge, having correctly concluded that the Agreement, in keeping with commercial sense, imposed some restriction as to permissible transferees, wrongly failed to give effect or proper weight to that conclusion when considering what the Agreement meant in its use of the term "bank or other financial institution". At the heart of Mr Rabinowitz's submission was his contention that that expression, read in its commercial context, limited transferees to those who were "bank-like" lenders active in the primary debt market, whose characteristics would thus be indicative of substance and integrity. It could not, he submitted, include institutions other than banks whose only or main involvement in debt was in trading it, that is in the secondary debt market.

28 On this issue, the Judge began by considering the commercial context in which the Agreement was made in 1997. On the agreed expert evidence before him, it was one in which trading by banks, their subsidiaries or affiliates in loans in the secondary debt market, for the purpose of managing a portfolio of debt or for other reasons, was at that time common. Non-banking institutions also participated in such secondary trading in debt at that time, but less commonly. Against that background, the Judge held that the parties to this 1997 Agreement must have intended that the class of potential transferees should be wider than that of bodies fitting the definition of a "bank".

29 As to how much wider, the Judge nevertheless took as his starting point the extent to which, if at all, the institution in question "shared" characteristics with a bank – a form of ejusdem generis approach. Thus, in paragraphs 36 and 37 of his judgment, he reasoned:

"36. It is clear that the parties intended that the class of potential transferees should be wider than bodies that fit the definition of 'banks'. In my view, 'banks' and 'other financial institutions' were intended by the parties to denote two different types of entity; otherwise the expression 'banks or other financial institutions' would be a tautology. …

37. It is possible to argue that 'other financial institutions' must share many common characteristics with banks or only a few characteristics with banks. Is there any indication in the Agreement that points to an intention of the parties that the key common characteristic is that of providing finance in the primary lending market and being regulated and accountable? In my view, there is not and … [counsel for Essar] could not point to anything specifically in support of his preferred construction."

30 In those passages, the Judge appears to have taken what he described as a possible premise or necessary starting point for his analysis, namely that, although an "other financial institution" meant something "different" from a "bank", it nevertheless had to have some of its characteristics. He did not seemingly consider that an "other financial institution" without any characteristics peculiar to a bank could have been intended by the parties. Thus, as his ensuing analysis in his judgment makes clear, his starting point was that one of the bank-like characteristics an "other financial institution" should have for the purpose was that of a lender of money. The question for him on Essar's case was whether it had also to be an original lender, that is in the primary lending market as distinct from becoming one by, say, transfer or assignment...

43 In my judgment, the Judge correctly concluded that the term "other financial institution" in the expression "bank or other financial institution" need not be a bank or even akin to a bank.

Clearly, the disjunctive form of the contractual expression, "bank or other financial institution", allowed for a financial institution that was not a bank, certainly not in the narrow conventional sense of lending money and/or accepting deposits for investment. However, given the use of that expression in a loan agreement allowing the transfer of the rights and obligations of the contract loan to a financial institution other than a bank, the assignment of its rights to anyone, and the known existence of a secondary market in such loans, I can see no basis for the Judge's starting point that one of the characteristics of such an institution was that it had to be a lender, whether in the primary market or otherwise. It is equally beside the point whether a potential transferee is technically a lender as an established trader in loans in the secondary market or, indeed that it would become a lender, if not otherwise qualifying as such, on becoming a transferee under the Agreement.

44 It follows, in my view, that it is equally immaterial in the commercial context of the Agreement whether a transferee is good for the loan monies under it, if, at the time of transfer, the borrower had not drawn them down – the fourth characteristic that the Judge held an "other financial institution" should share with a bank. It would be nonsensical if the meaning of a transferee under this Agreement were to turn on whether, at the time of transfer, the loan had been drawn down. The commercial reality of the Agreement, with its short draw-down period of 45 days and in its provisions as to transfer and to assignment, was that in the majority of cases it was catering for the trading of debts, often distressed debts, in the secondary debt market, that is, after draw-down. In that commercial context there can be no justification for insinuating into the term an "other financial institution", an ability to honour the original loan in the short draw-down period commonly a feature of such syndicated loans. As an exercise of construction, it would, as Mr Howard observed in argument, amount to the tail wagging dog.

45 Equally, it is difficult to see the commercial reality of the arguments advanced by Mr Rabinowitz (and at least in part acknowledged by the Judge in concluding that clause 27.2 imposed some restriction on transfer) in the greater reassurance for all parties in the restriction for which he contended for example, in the approach to and administration of the recovery of the loan. Those who buy debt, distressed or otherwise, are, by the very nature of the transaction and commitments undertaken, likely to have a shared interest with fellow lenders in the orderly payment of interest and or of any staged repayments of capital for which such an agreement or subsequent arrangement might provide and with which the borrower is complying. But where, as in this and many such cases, the borrower is in serious long-term default and its debt has been traded at a significant discount, the commercial reality is that each lender, whether original or transferee (or assignee) will have its own commercial interest in securing speedy or an otherwise effective means of recovery by whatever legal means are open to it. The trading in distressed debt and recovery of their outlay by those who have contractually secured their right to sell it, and by those who buy it, is necessarily a harsh commercial environment. It is not one in which parties to syndicated loan agreements providing contingently for the trading of debts the subject of them could ordinarily confidently expect or provide at the time of contract for enduring and harmonious relationships.

46 Behind all those considerations is Mr Howard's second main submission on this issue, namely that clause 27.1 of the Agreement, in its provision for the trading of the loans made under it, allowed members of the Syndicate, as lenders, though not Essar, as the borrower, to assign rights under the Agreement. That provision entitled the Syndicate members to assign to anybody the right to recover, in accordance with the Agreement's terms, monies advanced to Essar. It is true that, after assignment and before draw-down, Essar would have retained its rights to call for the loan monies against the Syndicate. It is also true that, after assignment and after draw-down, both Essar and the original Syndicate members would have been subject to

certain residual obligations under the Agreement, for example, obligations of Essar to indemnify Syndicate members (clauses 18 and 22) and continuing obligations of Syndicate members in respect of costs of redistribution between them of loan repayments (clause 24), costs of administration (clause 25) and agency fees (clause 26). Even allowing for those residual obligations, there would have been little point in either Essar or the Syndicate members intending or seeking to protect themselves against transfer by one or more of them to a financial institution that was not an established lender of proven worth or one that might not behave "suitably" in the administration and/or recovery of any loan monies transferred. Such protection, if it existed, could simply be set at nought by the Syndicate members selling their share of the debt resorting to assignment.
47 Given the history of this matter, it is a curiosity that the members of the Syndicate concerned and Argo seemingly did not turn their minds at an earlier stage than they have to the assignment route to recovery. If they had done, it would not have been open to Essar to take any point as to Argo's qualification to become an assignee and hence its entitlement to recovery of the loan monies concerned.
48 I should add, for the sake of completeness, that I have considered with care Mr Rabinowitz's recourse to a number of provisions in the Agreement to support his narrow construction of "transfer" within the ambit of clause 27.2. Without going into unnecessary detail, my view is that none of them considered individually or together, supports his contention that a transferee for the purpose of clause 27 must be an institution that lends money in the primary lending market. Such references were in the main clearly short-hand references to the original lenders under the Agreement or, in the event of transfer or assignment under clause 27 and as appropriate, a transferee or assignee, as inclusively defined in clause 33.1, the latter in its context, "without limitation" - that is, anyone at all.
49 For the reasons I have given, I would go further and hold - contrary to the reasoning of the Judge on this issue - that it is not a necessary characteristic of a transferee that its business should include bank-like activities, such as the lending of money, whether on the primary or secondary debt market or otherwise, or indeed that it should exhibit any particular standard of suitability or probity as a financial institution. All or most of Mr Rabinowitz's submissions in this respect turned on the use of the word "bank" and reference to what was expected of it in different contexts after draw-down. However, those few residual obligations of lenders after draw-down are, in my view, insufficient to colour or restrict the range of entities to which debt may be passed in the secondary debt market. In such circumstances – for which the secondary debt market mostly provides - the borrower has had the benefit of the money. It is its substance and integrity in meeting its repayment obligations, not those of the original or transferee lender's ability to continue to hold the debt that will, in most cases, be the matter for concern.
50 As to "suitability" of a transferee, given the spare terms of the Agreement's definition of "Transferee", its separate provision for unrestricted assignment and its commercial context, the notion of a transferee having to be a sound and respectable lender, whether in the primary of secondary market, was, in my view, clearly outside what the parties could reasonably have intended or expected of the Agreement. If the parties had intended it to provide protection to that effect, they could and would have done so in clear terms. For example, they could have stipulated that it should be a body subject to a particular regulatory regime or regimes, or, as Hallett LJ mooted in the course of submissions, have expressed the restriction as "a bank or other similar financial institution".
51 I, therefore, end up with a broader interpretation than did the Judge of the term "other financial institution" in the expression, "a bank or other financial institution", in the Agreement. In my view, the Judge, in identifying the nature of the restriction imposed by the Agreement on

the meaning of a transferee for the purpose of considering whether a putative transferee was entitled to claim repayment of debts of Essar passed to it, adopted too restrictive a meaning. He should have held that it was satisfied by proof that the putative transferee met the broad fifth criterion he identified in paragraph 38 of his judgement, namely having "a legally recognised form or being, which carries on its business in accordance with the laws of its place of creation and whose business concerns commercial finance", and whether or not its business included the lending of money on the primary or secondary lending market.
52 The commercial reality of a dispute such as this is that a lender under a syndicated loan agreement, whether original or by way of transfer or assignment, may and should be entitled to recover from the borrower monies lent when they become due and that the borrower, whether distressed or otherwise, has and need have little interest as to the commercial or financial status of the body to which the role of lender has passed. Here, Essar is a long-standing defaulter in making repayment of a substantial loan provided for by an agreement which, by its very nature, provided for the eventuality of it being traded at a discount as a distressed debt in the secondary debt market. There is no basis, whether in law as a matter of construction of the Agreement, still less of justice, for permitting it to avoid honouring its debt through the device of mounting an attack, well-founded or not, on the financial or commercial character or status of its lender.

Assignments raise many different issues. In the Enron bankruptcy proceedings Judge Arthur Gonzalez held that a claim that would be subject to equitable subordination in the hands of the transferor is subject to equitable subordination in the hands of a transferee.[13] Market participants criticised the decision as importing uncertainty into the loan trading market.[14] In September 2006 Judge Shira Scheindlin held in *Enron Corp. v. Springfield Assocs., L.L.C.*[15] that the banks could appeal the ruling immediately:

This is one of the rare cases in which an immediate review of an interlocutory order is warranted. The three prongs of section 1292(b) are met here and exceptional circumstances exist. The Bankruptcy Court's two rulings -- that equitable subordination and disallowance travel with the claim and that there is no good faith defense -- mean that if the Transferors' claims are found to be subject to equitable subordination and disallowance in the MegaComplaint Proceeding, then these findings will automatically subordinate and/or disallow defendants' claims. Enron correctly argues that the denials of the motions to dismiss may never need to be reviewed if the MegaComplaint defendants are not found liable of misconduct or of having received avoidable transfers or if there are settlements in either the MegaComplaint or Adversary Proceedings that end the actions against the defendants. But it is precisely the risk that these orders will go unreviewed that makes this an exceptional case...
The Intervenors provide a substantial and facially persuasive argument that the language of

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[13] Enron Corp. v. Avenue Special Situations Fund, II, LP (In re Enron Corp.), 333 B.R. 205 (Bankr. S.D.N.Y. 2005)

[14] See e.g. LSTA Legal Alert, LSTA to File Amicus Brief, http://www.lsta.org/story.asp?id=1653 .

[15] 2006 U.S. Dist. LEXIS 63223 (SDNY 2006).

section 510(c) and its legislative history, as well as case law, indicate that the "principles of equitable subordination" do not allow the doctrine to be applied to innocent claim holders. Without deciding the merits of this argument, I note that in its leading opinion on equitable subordination, the Supreme Court stated that it "need not decide today whether a bankruptcy court must always find creditor misconduct before a claim may be equitably subordinated." But the Court did state that "the circumstances that prompt a court to order equitable subordination must not occur at the level of policy choice at which Congress itself operated in drafting the Code."..

The important question raised by the Intervenors is whether the Bankruptcy Court, in holding that equitable subordination may be applied to an innocent claim holder, impermissibly operated at "the level of policy choice" which is reserved for Congress. Intervenors make the same argument with respect to the Bankruptcy Court's holding that an innocent transferee cannot assert a good faith defense to a claim of equitable subordination. Intervenors argue that this holding contradicts the Congressional policy choice, revealed in various sections of the Bankruptcy Code, that protects the claims of innocent transferees...

Enron argues that the Bankruptcy Court's holding that transferring a claim cannot immunize it from subordination is correct "as a matter of precedent, policy, equity and common sense." To reverse this holding would authorize creditors to "wash" their claims through transfer, thereby eliminating the remedy of equitable subordination, which no court decision has ever endorsed. Enron maintains that the Intervenors' argument that an innocent transferee's claims can never be subordinated is erroneous. As noted earlier, the Supreme Court in Nolan left open the question of whether there must always be creditor misconduct before a claim may be subordinated. After Nolan, two appellate courts have held that in certain circumstances, such as stock redemption claims and prepetition tax penalties, creditor misconduct is not a prerequisite for the application of disallowance.

Enron next argues that purchasers of postpetition claims are well aware of the risk that the claims they purchase may be subordinated, and protect themselves from this risk by obtaining contractual indemnities which are not available to those creditors whose claims arose prepetition. Relying on such indemnities (or other contractual rights), some Transferees in these proceedings have sued their Transferors for transferring tainted claims. Enron argues that this explains why the Transferors have taken the lead in litigating this motion: "the Transferors are asking this Court to make an immediate ruling that Enron must pay 'innocent' claim assignees so that the Transferors -- despite the inequitable conduct alleged in [MegaComplaint Proceeding] -- do not have to. Nothing could be more inequitable." Enron asserts that the subordination ruling correctly held that as a practical matter, it would be unduly burdensome to require bankruptcy estates to make distributions to all innocent claimants and then bring an action against transferors for recompense. Finally, Enron argues that the Congressional policy of protecting innocent transferees is best served by protecting Enron's prepetition creditors who have acted in good faith and by not requiring them to share their recoveries from the estate with creditors, or their transferees, who "acted inequitably to the innocent creditors' detriment."...

Loan Participations

Here is Wachovia Securities' outline description of the terms of its loan participation program:

"A loan participation is created when Wachovia elects to sell/participate a specific loan

to an investor; that is, Wachovia provides Wachovia Securities, Inc. (WSI) customers the opportunity to invest in loans made by Wachovia.
Terms and Structures
Structure
Wachovia provides WSI customers the opportunity to invest in specific Wachovia originated loans
Borrowers
Variable, including public, non-public, rated, and non-rated
Maturities
Typically overnight to 90 days
Rate
Trades on a money market yield (act/360), with interest paid at maturity; typically quoted as fixed rates or spreads over LIBOR
Benefits
Allows WSI customers to increase their yield versus comparable money market instruments and diversify their credit exposure
Considerations
WSI customers must make their own independent credit decisions with respect to any purchases, as loan participations are sold on a non-recourse basis, are non-negotiable, and are held to maturity
Delivery
Wachovia provides safekeeping facilities for WSI customers
Documentation
WSI customers must sign a Wachovia Master Participation Agreement prior to buying a loan participation."[16]

Loan Participation Programs Risk Being Recharacterised
See the discussion in **Re Okura** 249 B.R. 596 (Bankr. SDNY 2000) :

The Law of Participation Agreements
Participation agreements are a form of multiple lender transaction. Multiple lender transactions have been an investment device for more than one hundred years... From the beginning, ownership and control of some single mortgages, known as split mortgages, were in the hands of many as participants. These split mortgages, which came to be known as syndicated loans, were actually joint ventures where each participant received an executed note from the mortgagor... A syndicated mortgage, by virtue of its individual mortgage note, provides each lender recourse against the borrower...
Modern multiple lending agreements are often classified as either participation agreements (true participations), interbank loans, or syndication agreements... The most common multiple lending agreement is the loan participation which involves two independent, bilateral relationships: the first between the borrower and the lead bank and the second between the lead bank and the participants... As a general rule, the participants do not have privity of contract with the underlying borrower... See id. In an interbank loan, one bank lends the funds

[16] http://www.wachovia.com/corp_inst/page/0,,7_26_252_926,00.html

of another bank which, in turn, lends to the borrower. In a syndication agreement, the banks jointly lend money...

One aspect of loan participations that makes them attractive is the delegation of administrative tasks, like origination costs and servicing responsibilities to a lead lender... Participants are able to invest in loans offering good returns without having to invest in the administrative staff required to originate them on their own...

Other reasons that banks enter into participation agreements include: diversifying lending portfolios by region and property type.. spreading the risk associated with extending credit... achieving a higher interest rate on a loan than would be typically available if the participant had directly extended the loan to the borrower ...and avoiding the lending limits imposed on banks under federal banking law, see Hibernia Nat'l Bank v. F.D.I.C., 733 F.2d 1403, 1404-05 (10th Cir. 1984) (noting that the amounts "participated out" on a nonrecourse basis are not subject to the bank's lending limit).

D. Persuasive Authority

The courts are generally in agreement that a transfer of an undivided interest and participation in the context of a true participation does not allow the participant to assert a claim against the borrower.....

I found two of these cases to be particularly instructive because of their factual similarities to the matter before me. See In re Yale Express Sys., Inc., 245 F. Supp. 790 (S.D.N.Y. 1965) and Mason & Dixon Lines, Inc. v. First Nat'l Bank of Boston, 86 B.R. 476, 480 (M.D.N.C. 1988), aff'd, 883 F.2d 2 (4th Cir. 1989).

In In re Yale Express Systems, the debtor-borrower borrowed money from First National City Bank ("FNCB"). FNCB, in turn, sold an "undivided 40% participation" in the loan, pursuant to a participation agreement, to Marine Midland Trust Company of New York ("Marine")... The participation agreement provided that FNCB retained the sole right to agree to changes in the terms of the credit agreement with the debtor, except for changes in the terms of payment of principal, interest, premiums or fees... Also, FNCB retained the sole discretion to exercise any remedy in connection with a default...

Marine had a longstanding relationship with the debtor including a separate account it maintained with Marine.. In fact, the Yale Express court noted that Marine's longstanding relationship with the debtor undoubtedly served as an inducement for it to become a participant in the loan to Yale Express... After the debtor defaulted on the loan to FNCB and filed for bankruptcy, Marine sought to setoff the money it held on deposit against the money the debtor owed to FNCB (and indirectly Marine) under the loan.

The District Court denied Marine's application because it had no direct creditor relationship with the debtor under the participation agreement.. "I find that the provisions of the participation agreement between Marine and FNCB, particularly when read in the light of various agreements between Yale and FNCB negate the existence of any such creditor status as Marine now claims." .. The court reasoned that under the participation agreement Marine advanced money only to FNCB and that Marine's right to repayment would arise only upon receipt by FNCB of payment from Yale.. The court also relied on the fact that FNCB retained the right to modify the loan agreement and to enforce any rights under the loan agreement in the event of a default..

The Yale Express case is almost on all fours with this case. Here, as in Yale Express, BTM had a long-standing credit relationship with the Debtor which undoubtedly influenced its decision to become a participant in the LCA. Furthermore, BTM advanced money only to Fuji and, under the Participation Agreement, BTM's right to repayment arises only upon Fuji's receipt of

payment from the Debtor. Lastly, under the Participation Agreement, Fuji retained the sole right to modify the LCA (except for certain limitations similar to those imposed upon FNCB under its participation agreement with Marine) and to enforce any rights or remedies in the event of a default by the Debtor. Following Yale Express, I conclude that BTM is not a creditor of the Debtor.
Mason Dixon Lines Inc. v. First National Bank of Boston is analogous to this case. In Mason Dixon, the debtor borrowed money from First National Bank of Boston ("Bank of Boston")... On the same day that the debtor entered into the loan agreement with Bank of Boston, Bank of Boston entered into a participation agreement with Third National Bank of Nashville, Tennessee ("Third National").. The participation agreement provided that Bank of Boston would credit Third National with an undivided 50% interest in the loan..
Subsequently, the debtor filed for bankruptcy and Bank of Boston filed a proof of claim for the entire amount of the indebtedness due under the loan agreement.. During the course of the case, the debtor continued to make payments on the loan to Bank of Boston.. After two years of making payments, the debtor filed an objection to Bank of Boston's claim on the ground that Bank of Boston could properly claim only the percentage of the loan that has not been participated by Third National.. The debtor argued that the remainder of the loan was owed to Third National instead of Bank of Boston.. The Bankruptcy Court held that Bank of Boston's creditor status was not altered by the participation agreement with Third National and that Bank of Boston was entitled to file a proof of claim for the entire amount.. The Bankruptcy Court also found the debtor's motion so lacking in merit that it warranted the imposition of sanctions..
On appeal, the District Court affirmed the Bankruptcy Court.. Holding, in part, "that participants are not generally creditors of the debtor. Accordingly, any collections and filing of proofs of claim in bankruptcy should be made by the party to whom the underlying obligation is owed, namely the lead lender." ..
BTM attempts to muddy the otherwise clear picture that emerges from examining the authority in other jurisdictions by citing to a series of dissimilar cases which it contends stand for propositions in support of its case.
In re Drexel Burnham Lambert Group Inc., 113 B.R. 830 (Bankr. S.D.N.Y. 1990), does not support the argument that BTM has a claim against the Debtor. In Drexel Burnham, the loan arrangement was not a true participation. Rather it was a joint loan where certain interests were assigned to "Group Members."... These Group Members made individual advances, charged different interest rates and their interests were evidenced by individualized notes.. The loan agreement also provided that the borrower's "obligation to repay principal and to pay interest ran directly to each lender." ..

The loan agreement in Drexel is different from the one before me. That agreement had all of the hallmarks of a joint loan with, unlike in a participation agreement, a direct debtor-creditor relationship established between the borrower and each of the lenders. In fact, the Drexel court specifically noted that "[these features] underscore that this agreement far exceeds the usual single note joint loan nature of loan participation agreements." .. Since this case is neither factually nor legally similar to the one before me, it is unpersuasive...

Savings Bank of Rockland County v. F.D.I.C. is similarly unpersuasive... In that case, the participant, The Savings Bank of Rockland County ("Rockand"), sought to ascertain its rights under a particular participation agreement vis-a-vis the lead bank, Peoples National Bank of Rockland County ("Peoples"). In addition to this very different legal issue, the facts facing the court in Rockland are also distinguishable.

Peoples originally held approximately 164 consumer loans with a face value of about $ 4 million... Peoples soon realized that it was chronically undercapitalized and sought to sell the loans.. It sold an 80 percent interest to Rockland.. Peoples guaranteed Rockland's interest in the event of default and waived its own ability to "waive, modify, release or consent to postponement of any borrower's obligation" without the consent of Rockland.. Rockland also received an interest rate higher than the underlying loan.. Peoples then went into receivership and the receiver, the F.D.I.C., "disaffirmed" the participation agreement and refused to forward any of the $ 1 million it received as payments under the loans.. The question for the court was whether Rockland had an ownership interest in those proceeds. The court found that it did.. The question before me, however, is not whether the participant has an ownership interest in loan proceeds received by the lead lender, but whether a participant has a right to assert a claim against a debtor-borrower in bankruptcy.. The agreement before the court in Rockland, moreover, is very different from a typical true participation or the Participation Agreement. For example, the lead lender guaranteed Rockland's interest in the event of default; Peoples did not retain the right to proceed against the borrower; Rockland was promised a greater interest rate than the underlying loan agreement provided, and the overall lead position Rockland took in the loan. None of these facts are present in this case. Significantly, even in this case, Peoples, not Rockland, collected from the borrower. Since the Rockland decision is both factually and legally distinguishable from the matter facing me, I find it unpersuasive...

E. Status as Tenants in Common

BTM next argues that, under New York law, the Undivided Interest and Participation Clause should be construed to grant BTM the rights of a tenant in common with Fuji in the LCA. In order for a tenancy in common to exist "two or more persons [must] each own and possess an undivided interest in property, real or personal."... A tenancy in common, therefore, is created when a holder of an ownership interest in property assigns part of that interest to another party. Here, since only Fuji is a party to the LCA, the question is whether the Participation Agreement affected a partial assignment of Fuji's interest to BTM. Under New York law that question must be answered in the negative.

Notably, BTM cites to no case law in which a participation agreement, many of which contain clauses similar to the Undivided Interest and Participation Clause, is construed in the manner in which BTM asks me to construe this agreement. The reason is clear. The rights created by a tenancy in common are very different from those created by a participation agreement. "Under New York law, an assignment occurs only where the assignor retains no control over the funds, no authority to collect and no power to revoke." Natwest USA Credit Corp. v. Alco Standard Corp., 858 F. Supp. 401, 413 (S.D.N.Y. 1994) (citing Miller v. Wells Fargo Bank Int'l Corp., 540 F.2d 548, 558 (2d Cir. 1976). Here, none of these factors are present. Fuji, not BTM, retains almost complete control over the funds and the collateral. In addition, Fuji is given the sole right to collect monies under the LCA or to enforce rights in the event of a default. Furthermore, under the Participation Agreement, BTM does not have the right to assign its interest absent written consent from Fuji... An assignment at law contemplates 'a completed transfer of the entire interest of the assignor in the particular subject of the assignment, whereby the assignor is divested of all control over the thing assigned.'" (quoting Coastal Commercial Corp. v. Samuel Kosoff & Sons, Inc., 10 A.D.2d 372, 199 N.Y.S.2d 852, 855 (4th Dept 1960))). Since BTM has none of the ownership rights typically associated with a tenant in common, I find this argument lacking in merit.

F. Effect of Banking Regulations

BTM also maintains that because the portion of a lead bank's loan which is sold as a participation interest is not included in the lead bank's calculation of outstanding credit, the participated portion should be viewed for bankruptcy purposes as sold and assigned. See 12 C.F.R. § 32.2(j)(2)(iv) (1998). This regulation, which was established by the Comptroller of the Currency, is meant to ensure the solvency of banks by preventing banks from making excessive loans... Since participants adopt a proportionate risk of loss on an underlying loan to the extent of the participation, it is sensible that the participation is not included in the lead bank's books as an outstanding loan.
Despite the fact that participations are listed a certain way on lead banks' books, I disagree with BTM that this regulation has any relevance to the matter before me. In this case, the parties contractually agreed to limit BTM's rights and obligations under the Participation Agreement. They could have entered into a different type of arrangement with different rights and responsibilities, but they chose this one. Thus, I reject this argument as irrelevant.

G. The Extrinsic Evidence
Lastly, BTM claims that by viewing the "unique circumstances" of this transaction together, the court should find that the parties intended for BTM to have a direct claim against the Debtor. This broader perspective, it argues, can only be understood by reading the Participation Agreement in conjunction with the Extrinsic Materials.
As I discussed above, the Participation Agreement is unambiguous. Once that determination is made, the rule in New York is that parol evidence is not admissible to establish a contract's meaning... Here, the agreement is unambiguous and, as a result, I will not look beyond the four corners of the Participation Agreement to construe its meaning.
Even if I did consider the evidence offered by BTM, it does not show that the parties intended that BTM have a direct claim against the Debtor as to this participation agreement. The documents offered by BTM include an affidavit of Akira Takeuchi, Vice President of BTM, a letter from Okura-Japan to BTM and an "Agreement for Credit Instruction" [sic]. In the Takeuchi affidavit, Mr. Takeuchi asserts that the participation agreement should not be considered an independent contract but instead should be considered an integral part of a longstanding credit relationship between BTM and the Debtor's parent, Okura-Japan. According to Takeuchi, BTM and the Debtor have been doing business together since Okura-Japan's inception. This relationship has included negotiations between BTM, the Debtor and Okura-Japan regarding credit extensions, the submission of credit applications to BTM by Okura-Japan on behalf of the Debtor and an express guarantee of all of the Debtor's obligations, including those under the Participation Agreement.
None of these assertions, even if relevant, defeat the plain wording of the Participation Agreement and the two documents to which it refers, the LCA and the Participation Certificate. The fact that BTM had a longstanding credit relationship directly with the Debtor or with its parent does not mean that at any particular time they were not free to change this relationship or enter into a contract with another party, like Fuji, in order to do business indirectly with the Debtor. BTM and the Debtor, as sophisticated business entities, could have achieved a direct lending relationship by the terms of the agreement, but did not...Considering the Extrinsic Materials, therefore, would not alter the plain meaning of the Participation Agreement or BTM's status as a non-creditor in this proceeding as to the Debtor's indebtedness under the LCA.

VI. CONCLUSION
BTM's opposition to the Trustee's motion can be aptly summarized as a blunderbuss defense. Instead of identifying a single legal theory upon which to rely, BTM attempts to defeat the

Trustee's motion by making a series of unconnected, non-compelling arguments. Apparently, BTM was hoping that by creating a veritable cloud of arguments and issues, the underlying weakness of its position would not be exposed. Once the essence of BTM's position was identified, and its spurious arguments cleared away, it was apparent that its position is untenable. Furthermore, given the sophisticated nature of the parties, it is not unfair, from a policy standpoint, to strictly construe the terms of a participation agreement and hold the parties to the bargain they struck...

Interests in Loans Risk Being Treated as Securities under the Federal Securities Laws

If an interest in a loan is a security it will need to be registered under the Securities Act 1933 unless an exemption from registration applies. If an interest in a loan is a security the anti-fraud rules in the federal securities statutes will also apply.

Registration involves expense. Alan Palmiter says:

The costs of mandatory disclosure in securities offerings, borne ultimately by investors, are imposing. There are direct costs: the issuer pays for assembling mandatory information, retaining accountants to certify financial information, and hiring inside and outside lawyers to format and present it. There are indirect opportunity costs: compliance with mandatory disclosure diverts management attention from the issuer's business; protracted regulatory approval, typically in excess of two months, delays the issuer's access to capital and increases its capital costs. Regulatory compliance imposes competitive costs: public disclosure, ostensibly meant for investors, can harm the issuer's business when used by competitors, particularly privately-held competitors that do not make reciprocal public disclosures. And there are liability costs: public offerings expose issuers (and their shareholders) to fraud litigation that overreacts to misinformation, thus chilling public offerings and the beneficial disclosure of "soft" and other nontestable information; underwriters, accountants, and other participants pass on their liability costs to the issuer in the form of higher fees; mandated issuer warranties and "due diligence" verification in public offerings further chills the production of information.[17]

A security is:

any note, stock, treasury stock, bond, debenture, certificate of interest or participation in any profit-sharing agreement or in any oil, gas, or other mineral royalty or lease, any collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit, for a security, any put, call, straddle, option, or privilege on any security, certificate of deposit, or group or index of securities (including any interest therein or based on the value thereof), or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency, or in general, any instrument commonly known as a "security"; or any certificate of interest or participation in,

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[17] Alan R Palmiter, *Toward Disclosure Choice in Securities Offerings*, 1999 COLUM. BUS. L. REV. 1, 12.

temporary or interim certificate for, receipt for, or warrant or right to subscribe to or purchase, any of the foregoing; but shall not include currency or any note, draft, bill of exchange, or banker's acceptance which has a maturity at the time of issuance of not exceeding nine months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited.[18]

Interests in loans are securities if they fall under the definition of a “note”. The seminal case on the interpretation of the word “note” is *Reves* v *Ernst & Young*, 494 U.S. 56 (1990). The following case discusses the application of Reves to promissory notes issued by a broker.

Stoiber v SEC 161 F.3d 745 (DC Cir.1998)[19]

Judge Wald: Petitioner Gerald Stoiber is an Illinois broker associated with American Investment Services, Inc. ("AIS"). AIS is a member of the National Association of Securities Dealers, Inc. ("NASD"), a self-regulatory organization in the securities field. Stoiber borrowed a total of $495,000 from his customers, gave the lenders promissory notes in exchange, and used most of the money to invest in commodities. The NASD filed disciplinary charges against him, asserting that he violated the NASD Rules of Fair Practice by selling securities (the notes) without giving AIS prior written notice. Stoiber was sanctioned by the NASD and appealed to the ...SEC.. which affirmed the sanctions... The SEC denied a request for reconsideration...

A. Whether the Promissory Notes are Securities
Stoiber argues that the Commission erred in determining that the promissory notes he executed in return for the funds provided by his customers are properly classified as securities. If the notes are not securities, he could not be held to have violated Section 40.
The definition of "security" in section 3(a)(10) of the Securities Exchange Act of 1934, the source of the SEC's authority in this matter, includes a long list of financial instruments, beginning with "any note." Although courts initially interpreted "any note" literally ...an inquiry into whether a particular note is a security has become much more demanding under the test articulated by the Supreme Court in Reves v. Ernst & Young... The Court stated there that "the phrase 'any note' should not be interpreted to mean literally 'any note,' but must be understood against the backdrop of what Congress was attempting to accomplish in enacting the Securities Acts... Congress' purpose "was to regulate investments, in whatever form they are made and by whatever name they are called."..

Under the Reves "family resemblance" test, every note is first presumed to be a security but the presumption may fall away under either step of a two-tiered analysis... In the first step the notes under review are compared to several types of notes that the Court specifically said are not securities. Those are
the note delivered in consumer financing, the note secured by a mortgage on a home, the short-term note secured by a lien on a small business or some of its assets, the note evidencing a 'character' loan to a bank customer, short-term notes secured by an assignment of accounts receivable, [ ] a note which simply formalizes an open-account debt incurred in the

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[18] 15 U.S.C. § 78c(a)(10)

[19] And see also McNabb v SEC 298 F.3d 1126 (9th Cir. 2002) (promissory notes as securities.)

ordinary course of business (particularly if, as in the case of the customer of a broker, it is collateralized)[, and] ... notes evidencing loans by commercial banks for current operations... The comparison between the note in question and the excluded notes is to be made by considering four factors: (1) "the motivations that would prompt a reasonable seller and buyer to enter into [the transaction]," (2) "the 'plan of distribution' of the instrument," (3) "the reasonable expectations of the investing public," and (4) "whether some factor such as the existence of another regulatory scheme significantly reduces the risk of the instrument, thereby rendering application of the Securities Acts unnecessary.".... The note is not a security if this four-factor comparison reveals a "strong resemblance" to one of the enumerated types of notes... If a strong resemblance is not found, the court invokes the second step of the analysis--"the decision whether another category should be added...." .. This decision "is to be made by examining the same [four] factors.".. Whether a note is a security is a question of law, so the court applies this test de novo...

1. The First Reves Factor--Motivation
Reves explains the first factor as follows:
First, we examine the transaction to assess the motivations that would prompt a reasonable seller and buyer to enter into it. If the seller's purpose is to raise money for the general use of a business enterprise or to finance substantial investments and the buyer is interested primarily in the profit the note is expected to generate, the instrument is likely to be a "security." If the note is exchanged to facilitate the purchase and sale of a minor asset or consumer good, to correct for the seller's cash-flow difficulties, or to advance some other commercial or consumer purpose, on the other hand, the note is less sensibly described as a "security."...
We have little trouble concluding that Stoiber's main purpose for using the notes points in the direction of their being securities. All but $ 50,000 of the $ 495,000 raised from his customers was used for commodities trading in his personal account. Moreover, in reaffirmation statements signed when they declined Stoiber's rescission offers, the customers acknowledged that they knew at the time of the transactions that most of the money would be used for such trading. We think trading in commodities clearly falls under the "financing substantial investments" language in Reves.
Stoiber predictably disagrees. He argues that he was in the business of selling commodities and that he used the money to purchase inventory which he then attempted to resell at a profit. This he terms a commercial, not an investment purpose. Stoiber's regular business, however, was buying and selling on behalf of his customers; his earnings came not from the difference between the purchase and sale prices of the securities he traded but from commissions. Stoiber's trading in commodities was not part of his brokerage business, and so we cannot say that the commodities trading had a commercial purpose related to that business.
But even if we accept the proposition that personal commodities trading was a new business Stoiber planned to operate distinct from his usual brokerage business, use of the note money to buy an inventory of commodities is more akin to "raising money for the general use of a business enterprise" than the specific commercial uses cited in Reves such as remedying a cash flow deficit or purchasing a specific asset. Although the line between commercial and investment uses may not always be sharp, Reves' examples appear to distinguish between funding the enterprise generally and funding a discrete component or department of the enterprise. Because the purchase of commodities for reselling was at the core of Stoiber's "business" of trading in them, his use of the money to buy them is appropriately viewed as a general business use.
We also perceive that Stoiber's customers were primarily motivated by the opportunity to earn a

profit on their money. The NASD's investigator interviewed the note holders and testified that "the customers were providing the money because they knew Mr. Stoiber fairly well and trusted him and were interested in receiving a competitive interest rate." ... The rates they received – two points over prime – were described by the SEC, possessed of greater expertise than we, as "favorable."... And the Supreme Court has said a favorable interest rate indicates that profit was the primary goal of the lender... The fact that the rates were fixed and not variable does not suggest otherwise...
Stoiber argues that the customers provided funds because of the personal relationships he had with them. His evidence includes affidavits submitted by the note holders, which state that "I believe Mr. Stoiber is an honest and successful business person, and I believe him to be a good risk to repay me the loan; that is the reason why I loaned him this money." This display of trust, however, does not speak to the note holders' original motivations in making the loans. Rather, it speaks to the information available to them when deciding whether the notes involved a tolerable level of risk. The only evidence in the record that sheds light on the customers' motivations indicates that profit in the form of interest was their primary goal.
There is also a substantial difference between the goals of the parties in this case and those involved when banks provide character loans or commercial loans for current operations--two types of lending evidenced by notes that are not considered securities under Reves, and which Stoiber argues bear a "family resemblance" to his notes. Character loans are generally offered in an attempt to cement or maintain an ongoing commercial relationship with the borrower. A loan for current operations allows the borrower to achieve the commercial goal of continuing to operate a business smoothly during a period when cash inflows and outflows do not match up. These purposes do not characterize the notes here. Unlike with a character loan, the note holders were not trying to satisfy a potential or actual customer. Unlike with a loan for current operations, Stoiber was funding his entire endeavor, not just getting past a cash crunch.

2. The Second Reves Factor--Plan of Distribution
Under the second Reves factor, we examine the plan of distribution of a note "to determine whether it is an instrument in which there is common trading for speculation or investment.".. "The requisite 'common trading' " is established if the instrument is "offered and sold to a broad segment of the public...."..
This factor points in no clear direction in this case. While the terms of the notes do not preclude trading in a secondary market, none have been resold and there is no indication that anyone has considered reselling them. Nor do we think thirteen customers with whom Stoiber had a personal relationship constitute "a broad segment of the public."
On the other hand, Stoiber solicited individuals, not sophisticated institutions. While his solicitations included individual presentations, he offered his customers little detail. These facts suggest common trading... Banco Espanol de Credito v. Security Pac. Nat'l Bank, 973 F.2d 51, 55 (2d Cir. 1992).

3. The Third Reves Factor--Expectations
The Supreme Court described the third factor as follows:
Third, we examine the reasonable expectations of the investing public: The Court will consider instruments to be "securities" on the basis of such public expectations, even where an economic analysis of the circumstances of the particular transaction might suggest that the instruments are not "securities" as used in that transaction...
Whether notes are reasonably perceived as securities generally turns on whether they are reasonably viewed by purchasers as investments... When a note seller calls a note an

investment, in the absence of contrary indications "it would be reasonable for a prospective purchaser to take the [offeror] at its word."..Conversely, when note purchasers are expressly put on notice that a note is not an investment, it is usually reasonable to conclude that the "investing public" would not expect the notes to be securities... Here, there is no indication that Stoiber called the notes investments. Although of questionable value due to their conclusory character, affidavits submitted by the customers stated that the notes were not considered to be investments. The limited evidence thus suggests that Stoiber's investing public did not reasonably view the notes as securities.
This admission does not, however, add much to the inquiry into whether the promissory notes are securities. The Supreme Court itself described this factor as a one-way ratchet... It allows notes that would not be deemed securities under a balancing of the other three factors nonetheless to be treated as securities if the public has been led to believe they are. It does not, however, allow notes which under the other factors would be deemed securities to escape the reach of regulatory laws. In this case, then, the third Reves factor is basically a wash.

4. The Fourth Reves Factor--Need for Federal Securities Laws
The fourth and final inquiry looks to the adequacy of regulatory schemes other than the federal Securities Acts in reducing risk to the lender. Reves indicates that an alternative regulatory scheme, collateral, and insurance are all capable of reducing the risk to note holders sufficiently to render the protection of federal securities laws unnecessary...
Stoiber argues that "the circumstances of the loans and the creditor/debtor laws of the State of Illinois already provide adequate protection to the lenders." The circumstances he refers to are provisions in the notes for acceleration of payment upon default and recovery of collection costs and attorney fees. We think these are significantly less valuable than collateral or insurance and not by our thinking an adequate substitute for the protection of federal law. Unlike the securities laws, they do not provide any oversight over the initiation of the transactions or Stoiber's handling of the funds. Indeed, part of why the SEC believes that Stoiber's failure to provide his firm notice of the note transactions represents a serious omission is that it denied the note holders the value of oversight by the firm as to how he used the money and whether he fulfilled the note obligations. Unlike collateral and insurance, acceleration provisions and the like in the notes do not guarantee recovery by the note holders if Stoiber loses everything in his commodities investments or defaults for some other reason.
As for protection afforded by Illinois laws, Stoiber's reliance on them would expand the types of alternative protection cognizable beyond those contemplated in Reves...The risk reducing factors described by the Reves Court operate to prevent investors from harm in the first place or, like insurance and collateral, make recovery more likely after injury. In explaining the fourth factor, the Court looked to Marine Bank v. Weaver.. which involved certificates of deposit that were insured by the FDIC and the subject of substantial federal banking regulations... Similarly, the Second Circuit found an alternative regulatory scheme sufficient when the sale of the notes at issue was governed by guidelines of the Comptroller of the Currency. See Banco Espanol de Credito ... The provisions of Illinois law relied on by Stoiber are of a different type; he asserts basically only that state courts are open and that injured note holders can bring lawsuits. Like his "circumstances of the loans," however, this opportunity only operates post-injury and offers much less certainty than collateral and insurance. We do not think Illinois law renders the protection of federal securities law unnecessary in this case.
Comparing Stoiber's notes to character and commercial loans offered by banks also suggests that the protection of federal securities law is not redundant here. We agree with the SEC that bank loans and Stoiber's notes are very different; a bank has the expertise and the access to

records needed to carefully assess a person's creditworthiness and financial plans. Stoiber's customers had no such expertise or access. While the long-lasting relationships between Stoiber and his customers did give the note holders personal information about their solicitor not always available to bankers, we do not think this can be an adequate substitute for the objective data and analytical skills possessed by lending institutions. Information and evaluation of friends based on personal relationships is often subject to manipulation and skewed by other facets of the relationships.

5. The Reves Factors Viewed Collectively
Based on the four Reves factors, then, we conclude that the promissory notes executed by Stoiber are securities. They do not bear a strong enough resemblance to the categories of notes declared by the Supreme Court to be outside the definition of securities and the four factors do not suggest that these notes should be treated as a new non-security category. Admittedly the plan of distribution in part signals that the notes might not be securities, but that factor by itself is not dispositive. See Trust Co. of Louisiana v. NNP Inc. ... ("A debt instrument may be distributed to but one investor, yet still be a security."). The motivations of Stoiber and his customers and the lack of sufficient risk reducing factors other than federal securities laws strongly favor treating the notes as securities, despite the close plan of distribution. The remaining factor--the reasonable expectations of the investing public--is not relevant in this case.

The question whether loan participations might be regarded as securities was considered in **Banco Espanol de Credito v. Security Pacific National Bank**, 973 F.2d 51 (2d Cir 1992)[20]

Judge Altimari: In 1988, Security Pacific extended a line of credit to Integrated permitting Integrated to obtain short-term unsecured loans from Security Pacific. Security Pacific subsequently made a series of short-term loans to Integrated. Security Pacific sold these loans, in whole or in part, to various institutional investors at differing interest rates. Resales of these loans were prohibited without Security Pacific's express written consent. The practice of selling loans to other institutions is known as "loan participation." Short-term loan participation permits a primary lender such as Security Pacific to spread its risk, while at the same time allowing a purchaser with excess cash to earn a higher return than that available on comparable money market instruments. Security Pacific, as manager of the loans, earned a fee equal to the difference between the interest paid by the debtor and the lower interest paid to the purchaser. Security Pacific assumed no responsibility for the ability of Integrated to repay its loans. Indeed, each purchaser of loan participations was required to enter into a Master Participation Agreement ("MPA"), which contained a general disclaimer providing, in relevant part, that the purchaser "acknowledges that it has independently and without reliance upon Security [Pacific] and based upon such documents and information as the participant has deemed appropriate, made its own credit analysis.
In late 1988, Integrated began to encounter financial difficulties. In April 1989, Security Pacific refused a request by Integrated to extend further credit. Despite this refusal, Security Pacific continued to sell loan participations on Integrated's debt. Indeed, from mid-April through June 9,1989, Security Pacific sold seventeen different loan participations to plaintiffs-appellants.

[20] Cert. denied at 509 U.S. 903 (1993).

Unable to obtain enough working capital, Integrated began defaulting on its loans on June 12, 1989. Integrated subsequently declared bankruptcy.
As a result of Integrated's default, two sets of investors, who had purchased the seventeen loan participations, initiated separate actions against Security Pacific in the United States District Court for the Southern District of New York. Contending that the loan participations were "securities" within the meaning of the Securities Act of 1933 ("the 1933 Act"), plaintiffs sought to rescind their purchase agreements by alleging that Security Pacific had failed to disclose to them material facts about Integrated's financial condition in violation of § 12(2) of the 1933 Act.. Plaintiffs also claimed that Security Pacific's failure to disclose constituted a breach of Security Pacific's implied and express contractual duties under its MPA's, and a breach of Security Pacific's duty to disclose material information based on superior knowledge. Based on these common law claims, plaintiffs sought to recover their investment plus unpaid interest. Plaintiffs in each of the two actions moved for partial summary judgment on the securities claim. Security Pacific cross-moved for summary judgment on all claims. The cases were consolidated for argument.
In ruling on these motions, the district court concluded that the loan participations were not "securities" within the meaning of the Securities Act of 1933, and that, therefore, plaintiffs could not assert a violation under § 12(2) of this Act. In addition, the district court held that the express disclaimer provisions in the MPA precluded plaintiffs' common law claims. Accordingly, the district court granted summary judgment to Security Pacific and dismissed the complaints.....
It is well-settled that certificates evidencing loans by commercial banks to their customers for use in the customers' current operations are not securities. See, e.g., Reves v. Ernst & Young... However, as the district court noted, a participation in an instrument might in some circumstances be considered a security even where the instrument itself is not...
With respect to loan participations, the district court reasoned that "because the plaintiffs . . . did not receive an undivided interest in a pool of loans, but rather purchased participation in a specific, identifiable short-term Integrated loan, the loan participation did not have an identity separate from the underlying loan." ... Thus, Judge Pollack reasoned, because under Chemical Bank the loans to Integrated were not securities, the plaintiffs' purchase of discrete portions of these loans could not be considered securities.
On appeal, plaintiffs concede that traditional loan participations do not qualify as securities. Instead, plaintiffs contend that the peculiar nature of Security Pacific's loan participation program – which aimed at the sale of 100% of its loans through high speed telephonic sales and often pre-paid transactions – qualified these loan participations as securities. Specifically, plaintiffs argue that the loan participations sold by Security Pacific are more properly characterized as securities--in the nature of "notes"...
In examining whether the loan participations could be considered "notes" which are also securities, the district court applied the "family resemblance" test set forth by the Supreme Court in Reves .. .Under the family resemblance test, a note is presumed to be a security unless an examination of the note, based on four factors, reveals a strong resemblance between the note and one of a judicially-enumerated list of instruments that are not securities. ... If the note in question is not sufficiently similar to one of these instruments, a court must then consider, using the same four factors, whether another category of non-security instruments should be added to the list... The four Reves factors to be considered in this examination are: (1) the motivations that would prompt a reasonable buyer and seller to enter into the transaction; (2) the plan of distribution of the instrument; (3) the reasonable expectations of the investing public; and (4) whether some factor, such as the existence of another regulatory

scheme, significantly reduces the risk of the instrument, thereby rendering application of the securities laws unnecessary...
In addressing the first Reves factor, the district court found that Security Pacific was motivated by a desire to increase lines of credit to Integrated while diversifying Security Pacific's risk, that Integrated was motivated by a need for short-term credit at competitive rates to finance its current operations, and that the purchasers of the loan participations sought a short-term return on excess cash. Based on these findings, the district court concluded that "the overall motivation of the parties was the promotion of commercial purposes" rather than an investment in a business enterprise...
Weighing the second Reves factor--the plan of distribution of the instrument--the district court observed that only institutional and corporate entities were solicited and that detailed individualized presentations were made by Security Pacific's sales personnel. The district court therefore concluded that the plan of distribution was "a limited solicitation to sophisticated financial or commercial institutions and not to the general public."... We agree.
The plan of distribution specifically prohibited resales of the loan participations without the express written permission of Security Pacific. This limitation worked to prevent the loan participations from being sold to the general public, thus limiting eligible buyers to those with the capacity to acquire information about the debtor. This limitation also distinguishes Gary Plastic Packaging v. Merrill Lynch, Pierce, Fenner & Smith, Inc... which involved a secondary market for the instruments traded in that case.
With regard to the third factor--the reasonable perception of the instrument by the investing public--the district court considered the expectations of the sophisticated purchasers who signed MPA's and determined that these institutions were given ample notice that the instruments were participations in loans and not investments in a business enterprise...
Finally, the district court noted that the Office of the Comptroller of the Currency has issued specific policy guidelines addressing the sale of loan participations. Thus, the fourth factor--the existence of another regulatory scheme--indicated that application of the securities laws was unnecessary...
Thus, under the Reves family resemblance analysis, as properly applied by the district court, we hold that the loan participations in the instant case are analogous to the enumerated category of loans issued by banks for commercial purposes and therefore do not satisfy the statutory definition of "notes" which are "securities." Since the loan participations do not meet the statutory definition of securities, plaintiffs may not maintain their action for relief under § 12(2) of the 1933 Act.
We rule only with respect to the loan participations as marketed in this case. We recognize that even if an underlying instrument is not a security, the manner in which participations in that instrument are used, pooled, or marketed might establish that such participations are securities...

Banking regulators have noted that loan participation programs may involve safety and soundness issues for banks. The following excerpt is from an **Interagency Statement on Sales of 100% Loan Participations** from April 1997[21]:

[21] The agencies are the Federal Reserve Board (Fed), the Federal Deposit Insurance Corporation (FDIC), The Office of the Comptroller of the Currency (OCC), and the Office of Thrift Supervision (OTS). The statement is at http://www.occ.treas.gov/ftp/bulletin/97-21a.pdf .

SAFETY AND SOUNDNESS CONSIDERATIONS
If not appropriately structured, a 100% participation program can present unwarranted risks to the originating institution, including legal, reputation and compliance risks. The policies of a depository institution engaged in the origination of 100% loan participations should address safety and soundness concerns and include criteria for these programs. This criteria should address (1) the program's objectives, (2) the plan of distribution, (3) the credit requirements applicable to the borrower, and (4) the access afforded program participants to financial information on the borrower. In addition, the institution should establish procedures for ensuring compliance with applicable regulations and consistency with the institution's policies and procedures.

ADOPTION OF POLICIES AND PROCEDURES
Participation Agreements. The originating institution should use written participation agreements to set forth the rights and obligations of the parties participating in the program. The agreements should clearly state the limitations the originating and participating institutions impose on each other and the rights all parties retain. The originating institution should state, unequivocally, that loan participants are participating in loans and are not investing in a business enterprise.
Program Objectives. A 100% loan participation program should be structured to accommodate commercial objectives and not objectives geared primarily to investment in a business enterprise. Therefore, the motivations of the parties involved in the program (the originating institution, the borrower, and the participants) should be of a commercial nature. For example, banks may structure 100% loan participation programs to provide borrowers with short-term credit to finance their current operations, and to provide parties with excess cash the opportunity to obtain a short-term return by purchasing interests in these loans.
Plan of Distribution. The originating institution should take reasonable steps to ensure that the general public does not become the target of marketing efforts as a result of resales by loan participants. For example, the originating institution should have a program in place to ensure that participants are limited to sophisticated financial and commercial entities, and sophisticated persons, and that the participations are not sold directly to the general public. Steps that might be taken by the originating institution include retaining a right of first refusal on any bona-fide offer to a participant from a third party, or requiring the originating institution's permission, not to be unreasonably withheld, before a participant could sell or pledge a loan participation interest.
Credit Condition of the Borrower. The originating institution should structure 100% loan participation programs only for borrowers who meet the originating institution's credit requirements. Loan participations will also have to meet the credit requirements of the loan participants. In the event the originating institution decides to terminate its credit relationship with a borrower, or materially downgrades its relationship with the borrower, the institution should reevaluate whether originating new loans for that borrower for 100% loan participations is appropriate.
Access to Credit Information. The originating institution should allow potential loan participants to obtain and review appropriate credit and other information on the borrower to enable the participants to make an informed credit decision. Promotional materials should clearly state that the participants and not the originating depository institution are responsible for making the ultimate credit decision through the participant's own review of information pertaining to the borrower.

In relation to trading in distressed debt, and in particular trading in claims in bankruptcy,

it has been argued that there is another aspect of the definition of a security that is relevant: the investment contract. An investment contract has 3 aspects: (1) investment of money, (2) common enterprise, and (3) profits are expected to be made solely from the actions of people other than the investor. This is the test set out in SEC v Howey.

In his article, Covering the "Security Blanket": Regulating Bankruptcy Claims and Claim-Participations Trading under the Federal Securities Laws,[22] Thomas Donegan says:

First, purchases of claims and claim-participations from a bankruptcy estate creditor obviously involve the investment of money. Second, the claim purchase creates a commonality of interest between the debtor or reorganized entity and the claim purchaser (or subsequent purchaser), who assumes the role of the assigning claim holder…
…investors purchase claims or interests in claims based on the reasonable expectation of profits. These profits may be realized either from the purchaser's stake in the newly reorganized entity, from obtaining control of the entity by acquiring a sufficient position in a given class of claims to exercise veto power over the approval of any plan other than its own, or from reselling its claim (or participations therein) at a premium over its purchase price.
Finally, these profits must be expected from the "entrepreneurial or managerial efforts of others." Whether it be the original claimant or a subsequent claim purchaser who steps into the shoes of the seller, the investor is just one interested party whose economic fate is determined in large measure by the efforts of others: by the debtor-in-possession's management during the pendency of the case, by the plan proposed by the debtor-in-possession or an alternative plan, and by the outcome of the investor's class vote on the plan.
Furthermore, even where the investor accumulates a sufficient position to exercise some degree of control, the Supreme Court has determined that the securities laws do not merely protect "passive" investors. In the Court's view, "eliminating from the definition of 'security' instruments involved in transactions where control passed to the purchaser would contravene the purposes of these provisions . . . ." Traded claims and claim-participations therefore exhibit all of the necessary attributes to be considered "investment contracts," and thus are securities under the Howey test.

Donegan also argues that the courts' analysis of pre-petition claims in relation to loans and loan participations that results in them not being treated as the sort of notes which are securities should apply differently in the context of post-petition claims.

The Development of a Secondary Market in Loans

Syndicated loans are now described as an "asset class". We have already noted that there are firms which buy distressed debt in the secondary market. However, firms may also buy and sell debt which is not distressed. Other firms facilitate the secondary market in syndicated loans by providing pricing services[23] and brokerage services. The

[22] 14 Bank. Dev. J. 381 (1998).

[23] See, e.g. http://www.loanpricing.com

Loan Syndications and Trading Association[24] produces standard forms to facilitate the secondary market in loans. In 2002 a pilot program for CUSIP (Committee on Uniform Security Identification Procedures) numbers (in the US and Canada) for syndicated loans was launched. CUSIP numbers facilitate the clearing of trades in securities.[25] The LSTA press notice stated:

Key benefits of utilizing the CUSIP Standard as a Unique Common Loan Identifier
The CUSIP system establishes a common numbering system to reference syndicated loan credits. Presently, different identification numbers represent the same credit in proprietary systems utilized by various market participants, such as administrative agents, lenders, traders, potential buyers, regulators and various vendors to the market including pricing services and rating agencies. The use of a single CUSIP Number as a unique common identifier for all market participants will facilitate proper crediting of money movements, focus inquiries, create a common reference for market pricing and enable a more orderly exchange of information in an automated environment.
A critical advantage offered by the CUSIP numbering system is that it is endorsed by ANSI (the American National Standards Institute) and by ANNA (the Association of National Numbering Agencies). The CUSIP system conforms to ANNA's global guidelines that enable its members and the financial industry worldwide to adhere to standards and procedures for the creation, modification and deletion of unique identifiers. Adherence to ANNA's standards facilitates linking and cross-referencing separate local numbering systems in over 60 countries.
It is expected that the adoption of CUSIP numbers for syndicated loans will bring the following benefits:
* The precise exchange of information for drawdowns, repayments and fundings
* Improved reconciliation for inquiries and investigations
* Improved communication of information to the national banking regulators for Shared National Credit reviews
* Ease in utilizing internet-based trading and settlement platforms to exchange trade information and documents
* Increased efficiencies and improved settlement times for secondary assignments of loans
* Improved communication between front/middle/back office and counterparties regarding traded assets
* Enhanced reporting capabilities related to the settlement process
* Updated mark to market valuation information and ultimately automated feed of that information
* Assistance in providing automated feeds for updating ratings assigned by credit rating agencies

The adoption of CUSIP Numbers for syndicated loans is endorsed by members of the

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[24] http://www.lsta.org/

[25] See http://www.cusip.com/

FFIEC (the Federal Financial Institutions Examination Council) and is expected to be used in Shared National Credit reporting. The NAIC (National Association of Insurance Commissioners) requires regulated insurance institutions to use CUSIP Numbers in making their financial reports.

Some commentators have suggested that the federal securities laws should apply to sales of loan participations. See, for example, Richard Y. Roberts & Randall W. Quinn, *Leveling the Playing Field: the Need for Investor Protection for Bank Sales of Loan Participations*, 63 FORDHAM L. REV. 2115 (1995).